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TABLE OF CONTENTS

PROGRAM OF THE FORTY-FIFTH ANNUAL MEETING

WEDNESDAY, *December 28, 1932*

10:00 A.M. ROUND TABLE CONFERENCES

1. *The Rise of Monopoly in the United States*
   Chairman: Abbott Payson Usher, Harvard University
   DISCUSSION: Chester W. Wright, University of Chicago; John Ise, University of Kansas; Abraham Berglund, University of Virginia; Harry W. Laidler, League for Industrial Democracy
2. *Farm Debt and Distressed Land Holding* (Joint meeting with the American Farm Economic Association)[1]
   Chairman: J. D. Black, Harvard University
   DISCUSSION: B. H. Hibbard, University of Wisconsin; R. M. Green, Prudential Life Insurance Company; F. F. Hill, Cornell University; Herbert Simpson, Northwestern University; Thomas W. Cooper, University of Kentucky; D. L. Wickins, Bureau of Agricultural Economics; Chester Gray, American Farm Bureau Federation
3. *The Record of Insurance in the Depression* (Joint meeting with the American Statistical Association)
   Chairman: Frank G. Dickinson, University of Illinois
   DISCUSSION: David McCahan, University of Pennsylvania; G. F. Michelbacher, Great American Indemnity Company; E. L. Bowers, Ohio State University; C. A. Kulp, University of Pennsylvania; F. E. Wolfe, Procter and Gamble; S. H. Nerlove, University of Chicago

2:30 P.M. FIRST SESSION (Joint session with the American Association for Labor Legislation)
Presiding Officer: M. B. Hammond, Ohio State University
General Topic: *Reserves for Unemployment Insurance*
Papers: Richard S. Meriam, Harvard University; E. M. Burns, Columbia University
DISCUSSION: David A. McCabe, Princeton University; Warren B. Catlin, Bowdoin College; Paul H. Douglas, University of Chicago; W. M. Leiserson, Antioch College[2]

5:00 P.M. MEETING OF THE EXECUTIVE COMMITTEE

8:00 P.M. SECOND SESSION
Presiding Officer: Jacob H. Hollander, Johns Hopkins University
General Topic: *Stabilization of Industries*
Papers: George W. Stocking, University of Texas; C. T. Murchison, University of North Carolina
DISCUSSION: John D. Clark, University of Denver; Frank A. Fetter, Princeton University; Isador Lubin, Brookings Institution[2]

THURSDAY, *December 29, 1932*

9:00 A.M. BUSINESS MEETING—Reports of Officers and Committees, etc.

10:00 A.M. ROUND TABLE CONFERENCES

1. *American Economic Thought*
   Chairman: E. L. Bogart, University of Illinois
   DISCUSSION: E. A. J. Johnson, Cornell University; Broadus Mitchell, Johns Hopkins University; N. A. Weston,[2] University of Illinois; A. D. H. Kaplan, University of Denver; Leo Rogin, University of California
2. *The Formation of Capital: Measurement and Relation to Economic Instability* (Joint meeting with the Social Science Research Council)
   Chairman: Alvin H. Hansen, University of Minnesota
   DISCUSSION: David Friday, Washington, D.C.; Simon Kuznets, National Bureau of Economic Research; C. O. Hardy, Brookings Institution; Winfield Riefler; James Harvey Rogers, Yale University
3. *Size of Business Unit as a Factor in Efficiency of Marketing* (Joint meeting with the National Association of Teachers of Marketing and Advertising)
   Chairman: H. B. Price, University of Kentucky
   DISCUSSION: Paul L. Miller, Iowa State College; N. H. Engle, Bureau of the Census; W. H. S. Stevens, Federal Trade Commission; W. J. Donald,

James O. McKinsey and Company; E. W. Benjamin, Pacific Egg Producers, Inc.; H. P. Sheets, National Retail Hardware Association

2:30 P.M. THIRD SESSION (Joint session with the American Statistical Association)
Presiding Officer: Irving Fisher, Yale University
General Topic: Federal Reserve Policy Since 1926
Papers: Harold L. Reed, Cornell University; James Harvey Rogers, Yale University
DISCUSSION: E. W. Kemmerer, Princeton University; J. F. Ebersole, Harvard University

8:00 P.M. FOURTH SESSION (Joint session with the American Sociological Society, the American Statistical Association, and the Econometric Society)
Presiding Officer: President Raymond Walters, University of Cincinnati
Presidential Addresses: George E. Barnett, American Economic Association;[3] Luther L. Bernard, American Sociological Society;[4] Irving Fisher, American Statistical Association and Econometric Society[5]

FRIDAY, *December 30, 1932*

9:00 A.M. BUSINESS MEETING—Election of Officers, etc.

10:00 A.M. FIFTH SESSION
Presiding Officer: B. M. Anderson, Jr., Chase National Bank
General Topic: *The Tariff*
Papers: Philip G. Wright,[6] Brookings Institution; Percy W. Bidwell, University of Buffalo
DISCUSSION: Ernest M. Patterson, University of Pennsylvania; E. Grosvenor Plowman, University of Denver

2:30 P.M. SIXTH SESSION
Presiding Officer: Henry E. Hoagland, Ohio State University
General Topic: *Real Estate Speculation*
Papers: Ernest M. Fisher, University of Michigan; Herbert Simpson, Northwestern University
DISCUSSION: John R. Riggleman, Department of Commerce; Corrington Gill,[2] Federal Employment Stabilization Board

[1] To be published by American Farm Economic Association.
[2] Manuscript not received.
[3] To be published in the March, 1933, number of the *American Economic Review*.
[4] To be published by the American Sociological Society.
[5] To be published by the American Statistical Association.
[6] To be published in the *American Economic Review*.

THE purpose of the American Economic Association, according to its charter, is the encouragement of economic research, the issue of publications on economic subjects, and the encouragement of perfect freedom of economic discussion. The Association as such will take no partisan attitude, nor will it commit its members to any position on practical economic questions. It is the organ of no party, sect, or institution. Persons of all shades of economic opinion are found among its members, and widely different issues are given a hearing in its annual meetings and through its publications. The Association, therefore, assumes no responsibility for the opinions expressed by those who participate in its meetings.

F. S. Deibler

Secretary

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ROUND TABLE CONFERENCES

THE RISE OF MONOPOLY IN THE UNITED STATES

ABBOTT PAYSON USHER, *Chairman*

CHESTER W. WRIGHT.—In this discussion the term "trust" is used in the broad sense regardless of the form of organization adopted. The period covered is down to 1898, at which date the movement is greatly accelerated and new aspects develop, so that the conclusions here stated relative to the earlier movement are not necessarily applicable to that of subsequent years.

My method of procedure was inductive in character. I first made a list of the trusts formed within the period and then attempted to analyze their causes for growth and their sources of power. In view of the lack of adequate information it must be frankly admitted that the conclusions arrived at on this point are of a highly impressionistic character. The final step was to trace in the general economic development of the United States the changes tending to create conditions favorable to those causes of growth and sources of power which the previous analysis had indicated as most important.

By a cause for growth I mean a condition or influence impelling towards combination; by a source of power, a factor giving a combination an advantage over actual or potential rivals tending to build up and to maintain its monopolistic power. The same factor may appear in both categories; but this is not always the case, hence the differentiation.

In a broad sense there was but one important and impelling cause for the growth of trusts—the desire for greater profits. Other motives, such as the desire for personal prestige or leadership, were relatively insignificant. There are three main methods by which profits can be increased through forming a trust: (1) by checking the abnormal competition that is reducing profits below a fair return obtainable in an industry on the average under normal competition; (2) by reducing costs through securing any advantages of large-scale production and eliminating wastes of competition; (3) by raising prices through trust control above the level yielding a fair return so as to secure a monopoly profit.[1] These distinctions are difficult to apply in any concrete case, since they merge at an indeterminable point; yet they are useful for our purposes.

My analysis leads to the conclusion—hardly novel—that by far the strongest impelling motive leading to the formation of trusts at this period was the desire to check the heavy losses of potential profits resulting from an intensity of competition which at times threatened ruin to whole industries. The hope of also securing a monopoly profit was doubtless generally present, but was less important as an original and impelling impetus to action. Least influential of all was the expectation of reducing costs. The basis for my conclusions can only be summarized. In a large proportion of the industries where trusts were organized we have evidence of extreme competition and in most cases where more detailed evidence is available it is clear that the

[1] I omit the motive of promoters' profits as unimportant before 1898.

main concern was to check this competition. The large proportion of trusts formed which adopted a loose type of organization, such as the pool, rather than the consolidated type, indicates that reduction of costs was not the dominant objective. The pool's chief purpose is to check price cutting, and its potentialities for reducing costs, though varying with the form of agreement, are relatively limited and largely confined to reducing certain wastes of competition. Even among consolidations, many acquired inefficient plants and clearly relied more on buying out competitors or killing them off by resort to unfair methods of competition than on driving them out by lower prices based on lower costs.

Far more important than the motives leading to the formation of trusts are the sources of power of the trusts or the conditions which enabled those desiring to form a trust to build up and maintain monopolistic power; for without such power the movement would have slight social significance.

As a source of power, reduction of costs through obtaining the advantages of large-scale production and saving the wastes of competition does not appear to have been of marked importance in most cases at this period. The loose type of organization limited such potential advantage in most trusts. Among consolidations, while the savings of the wastes of competition would increase up to the point of absolute monopoly, this point was rarely attained; and it is doubtful if there were half-a-dozen instances—perhaps none—where the advantages of large-scale production continued up to the point where one concern could supply the whole market. Additional evidence is found in the weakness of so many trusts while the strength of others can best be explained on the basis of their possessing other sources of power. It should be added, however, that in a secondary manner the growing scale of production did in various ways further the growth of trusts.

Among the other sources of power—the one which my analysis suggests as by far the most important—was the use of so-called "unfair" methods of competition, especially where backed by large resources. It was not only very common but, even when combined with other sources of power, it was usually the chief element of strength. Probably next in rank was the possession of patent rights—of fairly frequent occurrence, though seldom the main source of power. Next might be placed control of a natural resource and then railroad discriminations, each a dominant source of power in only a few cases. Still less important was the check on foreign competition provided by an overprotective tariff. Finally there was a group of trusts not enjoying any appreciable and special source of power other than a common desire to act together to check competition.

The preceding analysis stresses the predominant importance of the growing ferocity of competition. The underlying economic developments chiefly responsible for this are: (1) the spread of the railroad system combined with the rate-making policies of the period; (2) the growing scale of production. For this period, at least, the latter has, if anything, been overemphasized and the former too generally neglected.

The years between about 1850 and 1885 mark the period during which the introduction of railroads exerted the most revolutionary influences upon the

economic order in this country. Except for the Atlantic coast region practically the whole country secured the main outlines of its railroad system during this period. In the seventies came the ferocious rate wars, rebating, and the adoption of a rate-making policy which stressed cutting rates to get traffic. Much the most rapid reduction in freight rates in the country's history occurred between about 1870 and 1885. The effects of these two developments on the intensification of competition are obvious.

The growing scale of production and size of the business unit were chiefly based on technological advance introducing machine methods, and the expansion of the market. Up to 1850, if not 1860, the introduction of large-scale factory methods of production had proceeded rather slowly. A marked impetus came from the Civil War. Then the two decades from 1870 to 1890 brought the most rapid rate of growth in manufacturing the country has experienced since census figures are available. The growth of population and per capita income provided a growing market, expanded geographically by the railroad developments. The railroad rate policy favoring highly competitive localities stimulated concentration of production. But, though individual plants were growing rapidly in size, the great and general expansion in the size of the business unit came after 1897. I would suggest as a tentative hypothesis that up to the latter eighties the domestic market for goods produced in most localities was generally expanding more rapidly than the size of the business unit, but that thereafter the reverse was more frequently the case; and that herein lies one reason for the accelerated growth and greater strength of the trusts in the subsequent period, despite the increased effectiveness of governmental opposition.

Other developments of minor significance can be briefly listed. The overdevelopment of certain industries during the Civil War was immediately responsible for several of the early pools. The downward trend in the general price level from 1865 to 1896 accentuated the severity of competition. The acceptance of the policy of high protection was advantageous for some trusts. The great activity in invention increased the number of cases where patent rights were a source of more or less power, though also at times undermining a source of power. Until declared illegal the device of the original trust form of organization was a facilitating factor. The changes in general incorporation laws started by New Jersey in 1888 were similar so far as the holding company is concerned, while the opportunities thus provided for promoters' profits were only significant after 1897. Until then the dominant factor underlying the trust movement was a combination of developments tending to produce in the last quarter of the nineteenth century a ferocity of competition more widespread and cutthroat in character than the world has ever witnessed either before or since.

John Ise.—Monopoly has plagued mankind for some thousands of years. It has existed in various forms at different times, and in many forms at almost all times; and in varying degrees has oppressed the people of every age.

In the ancient world, monopoly dominated the economic life to an extraordinary degree—state monopolies, and occasional privileged monopolies, usually

under complete domination by the state. The Pharaohs of ancient Egypt, and the Thinite monarchy as well, practically owned all of the land and mines, exploited the mines and carried on at least some of the trade, as state monopolies. The Phoenicians, too, are said to have carried on their trade through royal and privileged companies, somewhat as the English and French did in the late medieval period.

In early Greek history, we find a very different situation. Rugged individualists as they were, the Athenians enjoyed a far more democratic economic life, than the other earlier states, and they doubtless suffered far less from state or other monopoly. Large-scale establishments with slaves were a rare exception. In all history such establishments appear to a considerable extent only where there is an absolute monopoly of the branch of production concerned.

The market places in early Athens, where vegetables, fruit, cheese, fish, poultry, and game were sold, were generally simple affairs, and monopoly was probably difficult to secure. The corn trade, extremely important to a people dependent on imports, was regulated very closely. There were special magistrates in the control of the market. The sitophylakes saw that grain was sold at current prices, that millers sold flour and bakers bread at a rate proportionate to this, and that bread had a standard weight. Death was the common penalty for attempts to monopolize the market.

In the early history of Rome, there was a fairly democratic economic organization, in spite of the great privileged companies engaged in mining; and trade was reasonably free. Markets were held in the city every nine days; and the trade carried on with neighboring states was concentrated in the periodical great fairs. In the later Republic there was a growing domination of economic life by the state. Tenney Frank states that at the end of the Republic "the forces that worked in favor of large-scale and monopolistic production differed but little from those of a similar tendency today."

In the middle ages, as before, the industrial world was dominated by privilege and monopoly; but that privilege and monopoly was no longer imposed by a great despotic state, but usually by smaller units. Monasteries, lords, and military orders controlled most of the commerce and industry, and almost all of the land; and craft and merchant gilds grew up which limited economic freedom still further. The attention given to engrossing, regrating, and forestalling in medieval legislation indicates that those offenses must have been rather common.

The craft gilds took a considerable toll of the medieval consumers' dollar. As Weber says, "Externally, the policy of the gild was purely monopolistic." It usually undertook the policing of the industry in matters affecting the craft, and so controlled the technique and procedure; it tried to achieve compulsory membership; and in many places—conspicuously in Germany—it succeeded in establishing a gild district; that is, monopoly in a certain territory.

It is impossible here to discuss the various privileged companies of the later medieval and mercantilist period. In France, the state granted a great many exclusive privileges to private domestic enterprises; in England, ac-

cording to Levy, there was scarcely a commodity which was not the object of a monopoly. Many of the English monopolies were held by joint stock trading companies, controlling trade with various parts of the world.

The first colonies in America were planted by noble proprietors or privileged companies; but from the first the colonists were generally hostile to monopolies, and granted monopoly privileges only where the public utility aspects of the situation clearly warranted such action. Such monopoly as existed in the early history of this country was, for the most part, of a very different character—or perhaps it should be termed lack of competition rather than monopoly.

From a study of an isolated pioneer community in central Kansas, I was driven to the conclusion that those people probably suffered more from monopoly—or from lack of competition—than is generally supposed. In the first few years of that community, there was only one store within a radius of sixty miles, and this store afforded the only market for the settlers' products, and the only source of practically all goods purchased. The proprietor retired with a fortune in about ten years. When the railroad came, a town sprang up, but much of the business was monopolized as before. The first bank soon failed—for the benefit of one of the officers—but the next bank had a near monopoly for twenty years, lending money to farmers at a high rate of interest, and discounting lightning rod and pack peddler notes at rates even higher, in addition to regular banking business. It proved highly profitable. The grain elevator which came with the building of the railroad monopolized the grain market for years, and one cattle buyer bought most of the cattle that were shipped out of town. Farmers occasionally hauled grain twenty miles, or even more, to get to another railroad, and into a somewhat competitive market. When a flour mill was built, it afforded a competitive market for only a small amount of grain, and for a small number of cattle each year. When the first lord proprietor of the community retired, a lumber yard was established, at which the farmers bought lumber for their new houses and barns at such monopoly prices that the lumberman was within a few years the wealthiest man in the community. When a threat of competition appeared, he built a second yard across the street to preserve his control of the market. A line creamery was built and soon there was complaint of falling prices paid for cream—with what justice I was unable to learn. In retail stores there was competition, but of course it was sluggish.

Thus we see that for most of our present forms of monopoly we have historical precedent—perhaps running back to antiquity. We have no federal fiscal monopolies, but in such monopolies as the steel corporation, and doubtless other capitalist monopolies, we have something similar to the privileged monopolies of late medieval times—recognized, if not definitely approved, by the state. Labor monopolies have much that was common to the gilds of Greek, Roman, and medieval times. Today banking and finance are often closely associated with monopoly just as in Roman and medieval times, especially in medieval Italy.

It is the thesis of this paper that monopoly is a very old disease; that it

has flourished in different forms almost everywhere and at all times. Various considerations indicate that monopoly was almost always a very heavy burden, even down into the nineteenth century. The monopolies that exploited the people a generation or two ago, took money that had a high marginal utility. We are so rich—or perhaps I should say, we have been so rich, and soon will be so again—that we can afford to pay monopoly prices without great suffering. This is doubtless an important reason for the extraordinary apathy of the people toward monopoly during the past decade or two.

I trust that nothing in this paper will seem to suggest a policy of ignoring or condoning the practices of the great capitalistic combinations, or a let-up in our efforts to get them under control. There is some reason to believe that it may be easier to control them finally, than to secure relief from local monopoly conditions in large cities. These larger concerns, by their very size, are somewhat in the open, and may easily be made more so. When they attain a considerable element of monopoly power, they will lose much of the vitality that competition is supposed to insure; and, as the socialists suggest, may even finally be taken over by the government. The larger they become, and the greater their monopoly power, the more easily this may be done, and the less will be the loss in efficiency involved. Perhaps we may have to admit that, in the long view, the era of modified competition was a brief and exceptional era in human history, and admit the inevitability of further monopoly in the system which is destined to follow competitive capitalism.

A. Berglund.—Present-day industrial technique is characterized by what is called large-scale production, or large output by single units or ownership organizations. It is true that the large producing unit has not yet appeared in several important branches of industry.

Large-scale production and monopoly production are not synonymous terms. Large producing units may compete as well as small units. When large business organizations are so formed as to eliminate competition locally, this elimination by virtue of rapid and cheap transportation is often offset by rivalry from similar organizations in more remote regions. It cannot be said, therefore, that the development of large-scale production has thus far sounded the death-knell of competition as a regulative factor in business and in the adjustment of market prices.

In certain instances the very nature of the product or services rendered practically precludes any real competition. Two or more competing telephone companies, for example, would be something of a nuisance rather than a service to patrons. What are called public utilities, especially where they serve local communities, are generally monopolies. Such monopolies are recognized at law, and charges for the services they render are fixed, at least in theory, by governmental authority. In the railroad business, where a considerable measure of competition still exists, rates do not reflect the ups and downs of trade as do ordinary commodity prices where commercial rivalry is relatively free.

In addition to these instances and others that might be mentioned, questions are being raised as to the possibility of maintaining competition as the

sole or principal regulating factor in the fixing of price levels in industries to which our anti-trust laws apply.

It has been said that men compete in order to destroy competitors. Competition, according to this view, is a scramble for monopoly power. Let competition have full sway and the result will be one sole survivor—a monopolist. This contention is not entirely true, if the competing units are many and the fields open on practically the same terms to all. The attainment and maintenance of monopoly power for most industries is conditioned upon the control of some strategic or crucial step in the productive process like exclusive ownership of the sources of raw material, possession of patent rights, control of transportation or special transportation favors by common carriers. The preservation of competition is largely a matter of preventing any control of the kind indicated.

Over a considerable, and apparently increasing, part of our industrial domain forces are at work making monopoly control in some form practically inevitable. These forces are especially noticeable when large-scale production limits the number of producers who can supply the country's demand to but a few, and when the capital invested in such production takes fixed and highly specialized forms. How far these forces have operated to create and maintain monopolies in the United States is difficult to estimate.

A good illustration of an industry whose technique calls for a high degree of concentration is the manufacture of what is called tonnage steel; i.e., steel produced in large amounts and used in the making of plates and sheets, rails, structural shapes, pipes and tubings, and the like. It is good economy for the producer to control his supply of iron ore and metallurgical coal and manufacture his own pig iron.

The showing with reference to the economies brought about by a vertical combination of successive stages in production does not tell the whole story of the effectiveness of very large producing units. Most tonnage steel is what is called soft steel—steel of low carbon content and with little but generally some alloy metal. The demand for this steel, however, has generally been such that the producer would provide a product of varying degrees of softness and hardness according to the uses to be subserved and the differences in the shapes to be assumed. Production is thus facilitated by separate furnaces and rolling mills. The growing demand, too, in late years for certain alloy steels, particularly in the manufacture of automobiles and certain kinds of heavy machinery, is leading to a further elaboration in both vertical and horizontal directions.

The manufacture of tonnage steel, therefore, is an industry in which efficient production involves concentration in a very limited number of concerns or corporations. The annual output of heavy standard steel rails in the United States (including the exported product) under normal conditions is from two and a half to three million tons. The great bulk of this tonnage is furnished by the plants of three or four companies.

It has been said that two or three large producers can compete as vigorously as a hundred small producers. In a sense this is true. But competition, if it is real and has any material influence on price levels, will almost inevitably act differently in the two cases.

Reverting again to the steel business, let us note what has happened during the past thirty years, or since this industry came under the control of a few large corporations or consolidations. The outstanding producer in this field, of course, is the United States Steel Corporation. If one were asked whether or not this organization exercises monopoly control over the output of any one or more of the leading groups of steel products, he would have to answer that in a technical sense it had no such control. There is little or no evidence of the resort to unfair competitive methods looking toward the elimination of rivals. Neither has there been any marked disposition, either on its own initiative or in conjunction with independents, to raise prices unduly. Whether or not steel prices are too high is a matter of opinion, but many persons acquainted with the steel business characterize the price policy of the corporation as a moderate one. Nevertheless, an examination of steel prices shows that since the organization of this corporation some quotations have been pegged at certain figures for long periods—in one case for several years at a time—irrespective of the fluctuations of trade. Whether such pegging was made possible by virtue of the size of the corporation in an effort to stabilize prices in which independents on their own initiative joined or by some joint action with one or more of the larger independents is not known. In either case some control was exercised. This, of course, is not saying that the policy of price stabilization has been harmful to the public. In fact much may be said in favor of such stabilization. However, a stabilized price is not strictly speaking a competitive price.

Closely connected with an industrial technique which in some lines of production makes for a high degree of concentrated control is the importance of capital in fixed and highly specialized forms.

In some branches of manufacture the care and upkeep of idle equipment is nearly as costly as the maintenance of the same equipment steadily employed, to say nothing of interest charges on the investment involved. In certain metallurgical industries the spasmodic or intermittent use of furnaces is much more costly than their constant use. Powerful pressure from the very nature of such industries is thus brought to bear upon producers to secure some measure of stabilization.

Price stabilization is sought not necessarily in the interest of high selling values or what is called monopoly prices, but for the purpose of limiting those fluctuations in demand that often result from market uncertainty. A business organization with a large capital outlay, a great part of which is in fixed and highly specialized forms, has reason to fear a price demoralization wherein the costs per unit of output tend to mount rapidly at the very time that market conditions force prices downwards. Price stabilization, however, can only be brought about when a single organization controls a large enough proportion of a country's output to influence independents to adopt its price policy or act in unison with other organizations so as to establish some kind of market control. This in a sense means monopoly but it is monopoly which arises out of much of our present-day technique.

In many fields great industrial organizations are appearing whose price policies are only to a limited degree, if at all, affected by ordinary competitive

conditions. Grover Cleveland's famous aphorism, "A condition confronts us, not a theory," may well be applied to this situation. Or to state it more precisely: over an important part of our industrial organization a condition confronts the nation to which a past theory does not apply.

Harry W. Laidler.—The valuable papers by Professors Wright, Ise, and Berglund re-emphasize the great importance of monopoly trends in the industries of the United States. From 1919 to 1928, over seven thousand firms were merged or acquired in mining and manufacturing alone. Two hundred corporations controlled in early 1930 nearly one-half of all non-banking corporate wealth in the country, and received 43 per cent of the income of non-banking corporations. If the trend of the last twenty years continues, by 1950, these two hundred corporations will control about 70 per cent of all corporate activity, while if concentration continues they will control about 85 per cent of the non-financial corporate wealth.

Professor Ise has cited a surprisingly long list of governmental monopolies. Most of the monopolies of the past ages, unfortunately, were run not in the interest of society at large, but in the interest of a king or a small governing group who dominated the political machinery of the country. The government monopoly of the future, if it is to solve the problems of present-day industry, must have as its object the welfare of society, not the aggrandizement of the political group.

The days of free competition in many industries are over, never to return. Free competition was merely a passing phase of our industrial system. The growth of large-scale production and quasi-monopoly has weakened the arguments formerly used against an advance to public monopoly and makes the transfer from private to public ownership less difficult. It is merely necessary to socialize one, two, or three corporations in a given field, in order to control the greater portion of the industry.

The modern government monopoly, too, is showing a flexibility not shown by monopolies in the past. Instead of departments of government, they are coming to be public corporations of the type of the Port Authority of New York, semi-autonomous in their nature and removed from certain undesirable restrictions of political leaders. If to this corporate structure could be added a functional control which gave adequate representation to all parties at interest, an efficiency combined with democracy of a high order might be expected in the commensurate future.

Our great industries are industries involving mass production. If the products they are able to produce are to be consumed, they must be purchased by the masses. But, with our present-day control of industry, there has been a growing lag between our power to produce and the power of the masses to consume. If a balance is to be made between our productive machinery and our power of consumption, increasing numbers of thinkers insist that we must change our methods of industrial control and introduce planning on a national scale. The important power of planning cannot be left to private monopoly intent on private profit.

If these contentions are substantially correct, does it not present to economists a great challenge; a challenge to do their part not in seeking to re-

store the planless competitive system of the past, but to place our industrial structure under such social control that our increasingly complex machinery of production and distribution will bring security, eliminate poverty and useless luxury, and bring about the full utilization of the resources of the country for the common good.

Vanderveer Custis.—Much has been said at this session about the problem of monopoly; but in considering it we should not forget that there is also a serious problem of competition. Such competition as can exist provides very inadequately in many fields of industry for the adjustment of production to demand. In many cases it involves losses from the point of view of society as serious as those that result from monopoly, at least when monopoly is subject to even a moderate degree of public regulation.

While a study of production and prices under assumed conditions of perfect competition is both legitimate and useful, we should recognize that we never have conditions of perfect competition. Such conditions include among other things a large, if not an infinite, number of competitors; but in many fields of industry economy in production results in a small number, with a large share for each in the total supply. Where the number is large the action of a typical concern can have but little effect on the price. Where it is small, the action of a typical concern, if not offset by that of the others, can have an appreciable effect on the price. Under such circumstances an understanding, not necessarily in the sense of an agreement, but merely in the sense that each has a knowledge of the situation and an appreciation of its significance, may put some restraint on competition. From one point of view this is a problem of monopoly, but it arises out of the imperfect character of such competition as is practicable.

It has been said that pooling does not bring about economy in production; but marketing is a part of production, and while pooling has doubtless been undertaken primarily as a means of restraining competition, it may bring about significant reductions in the cost of marketing.

One of the chief reasons for the inadequacy of competition as a regulator of production lies in the importance of fixed costs. This is conspicuous in the case of steel, as has been pointed out by Professor Berglund. It is conspicuous in the case of oil; and it is worth noticing that two of the states that have been most opposed to trusts have resorted to martial law to restrict the production of petroleum. It is not so generally recognized that in the case of agriculture some of the most serious problems arise out of competition in the presence of fixed costs; though it is clear enough that something is wrong. The farmer's land represents to him a fixed cost. So do most of his improvements and much of his equipment. The government has tried to encourage him to restrict production, but the individual's share in the total output is so small that if he were to restrict his production he would increase his unit cost, but have practically no effect on the price. This problem is distinctly one of competition, and recent governmental attempts to deal with it have really been attempts to introduce into the situation an important element of monopoly.

Frank recognition of the evils of competition does not imply that com-

plete monopoly is the only alternative. There are degrees of monopoly, and in some cases a very moderate restriction of competition may be all that is needed. How much competition should we have? What limitations should be imposed upon it or upon monopoly? The answers to these questions will differ from industry to industry and no single or simple formula can be applied. It need not be denied that the presence of monopoly gives rise to difficult problems of regulation, but the inadequacies of competition as a means of regulation should be more generally recognized than they are.

Francis Tyson.—May I point out that the emphasis Professor Berglund makes in his pertinent illustrative material from the steel industry needs to be shifted somewhat in the light of amazing recent changes?

Obviously, the tendencies making for price control had not operated to stabilize the industry so far as control of production was concerned.

Until the depression, reduction of costs by virtue of integration and large-scale production was not a relevant issue, as compared with nonexistent small units, as the battle was one of giants. Six or eight companies produce over 90 per cent of the steel ingot tonnage in a good year. They enjoy similar advantages and include the new low cost National Steel Corporation (the new blast furnaces of the industry, for instance, produce not 600 to 700 tons daily, but 1000 to 1200, and cost, with equipment, not 2 million dollars, but 4 to 5 million dollars a unit).

The real problem is that of uncontrolled large-scale competition, sustained by the expenditure by the Corporation of some 110 million dollars on steel ingot capacity at South Chicago and Gary, and about 70 millions at Lackawanna, and Sparrow's Point by the Bethlehem, 1928-30. The problem of controlling new investment and relating capacity to rate of increase of demand was still awaiting solution (with the depression, of course, came advantages to small steel producing units, because of the collapse of scrap price —scrap is new in acid open hearth steel making—as compared with the continuous pig iron process of the big units).

But the great problem of the industry is still that of excessive, unused capacity, the pressure of fixed charges, and depreciation costs. If depression continues, there will be strong pressure toward lowered prices, and even toward liquidation and reorganization in some important sections of the industry. Failure of price understanding to bring production control would seem to make some such approach to national organization for the industry, as suggested by the Swope plan, pertinent indeed!

THE RECORD OF INSURANCE DURING THE DEPRESSION

FRANK G. DICKINSON, *Chairman*

In opening this session greetings were extended by Mr. Hardcastle, vice-president of the Union Central Life Insurance Company, in whose library the meeting was held. Four papers were read and were discussed. The following report presents an abstract of the material and ideas that were set forth.

DAVID MCCAHAN.—Strange as it may seem, the general health conditions of life insurance policy holders have improved during the depression. It is interesting to note that the death rates per 100,000 for ordinary and industrial business, as indicated in a recent address of Dr. Augustus S. Knight, before the Twenty-sixth Annual Convention of the Association of Life Insurance Presidents, were lower for the first ten months of the year 1932 than for a similar period in any of the preceding ten years. Moreover, the average for the last three years is better than for any one of the eight years preceding 1930 with the exception of 1927. It is significant, however, that this record is very largely due to the inclusion of industrial business. If ordinary business be taken by itself, the death rate for the first ten months of 1932 was higher than for any of the preceding ten years, except 1929, and the average for the three years of the depression was substantially higher than for any of the eight years preceding 1929.

Another important influence upon the mortality ratios of ordinary companies has been the "Jumbo" policies. The mortality under policies of a large size has been very much higher than under smaller policies and weekly premium forms.

The disability problem antedates our present economic troubles. As we all know, the disability situation was quite unsatisfactory even during the prosperous years preceding the crash of 1929, one authority having estimated about two years ago "that the ultimate losses of life companies from the disability experiment will run somewhere between $100,000,000 and $250,000,000." The report of the Special Committee to the National Convention of Insurance Commissioners was submitted in September, 1929, and the uniform clause became effective on July 1, 1930. But the correction had not been made sufficiently soon, so starting in the fall of 1931, many companies restricted the coverage offered to waiver of premium, and withdrew entirely from the field of income disability underwriting, their exit being so hurried that it assumed the nature of a stampede. Others have substantially modified their clauses and increased their rates. The important modifications have been extension of the waiting period to six months, lowering of the age before which disability must occur to fifty-five, and reduction of benefits to waiver of premium and five dollars monthly income per $1000 of face. Underwriting rules have, of course, been tightened and the maximum amount of protection available to the prospect has been materially reduced.

There has been a disposition on the part of some to believe that we may be entering into an era such as from 1874 to 1885. Throughout that twelve-

year period the volume of insurance in force for all companies reporting in New York was lower than in 1873. In fact, not until 1886 was the amount as great as in 1870. I am personally not inclined to share this pessimistic point of view for a number of reasons. In the first place, the public was not as thoroughly educated on life insurance in the seventies and eighties as it is at the present time. Moreover, policy loans did not play the important part in administering to those in need or distress that they have played during the past three years. Life insurance itself was not, generally speaking, as well administered or supervised. Finally, and to me this is very significant, life insurance was not viewed from an investment angle, but even if it had been, other avenues for profitable investment which were beginning to open up as a result of economic changes and advancements would have competed more vigorously for the policyholder's dollar than those which appear to be available today. As indicative of the importance which should attach to the growing concept of life insurance as an investment is the recent marked increase in the sale of annuities, retirement income, single premium, and endowment policies, all of which contain a large investment element.

From the standpoint of the individual underwriter, the decrease in amount of business written seems more important even than the slight shrinkage in outstanding insurance. It has been estimated by Thomas A. Buckner, president of the New York Life Insurance Company, that new life insurance, including revivals, increases and dividend additions will this year approximate $14,700,000,000 which is 23.7 per cent less than the amount written in the peak year of 1929. Incidentally, it will be approximately 16 per cent less than the 1931 business.

The turnover in life insurance ranks is admittedly very large. Exact figures are not available but it is ordinarily assumed that from 225,000 to 250,000 persons hold licenses. Of these, according to estimates of various authorities, less than 10 per cent will write more than 90 per cent of the business. It was further estimated in an address given in 1931 by Thomas I. Parkinson, president of the Equitable Life Assurance Society of the United States, that the average annual turnover of agents is approximately 50 per cent.

More significant perhaps than the slight shrinkage in the total outstanding insurance is the tremendous volume of surrenders and lapses. During the year 1931, the last for which complete data are available, the new ordinary, industrial, and group business written and paid for of 342 companies totalled $17,226,248,427. Of this, $4,847,103,856 was industrial. For the same period, $15,870,864,610 of business went off the books, of which $4,780,868,796 was industrial. However, $12,321,512,397 of the total terminations represented surrendered or lapsed policies, the remaining three and one-half billion constituting all policies which terminated by death, maturity, expiry, change, and disability. When 3,253,231 ordinary policies totalling $7,656,853,359 and 19,308,347 industrial policies for an aggregate of $4,411,782,844 go off the books in one year, the problem is unquestionably one of grave concern. Reduced to percentages, we find that on all classes of business terminated in 1931, 6.1 per cent of the volume was terminated

by death, .8 per cent by maturity, 8.3 per cent by expiry, 7.1 per cent by change and .1 per cent by disability, 77.6 per cent being terminated by surrender or lapse. Even if industrial and group insurance be excluded, ordinary insurance alone shows a record of 75.7 per cent surrendered or lapsed. There is no reason to believe the record as a whole would be any better for 1932 although the tide in the demand for surrender values has turned.

Policy loans now total about three and three-quarter billions of dollars or 18.4 per cent of all assets, the latter percentage having increased from 13.3 per cent since 1929. Ability to make such loans and meet other cash demands reflects great credit upon the life insurance institution but the problem of conserving the contracts against which these loans have been granted will not be easily solved.

Before leaving the subject of surrenders and loans, it is only fair to state that in spite of the impressions produced by the recent political campaign, very little assistance has been extended to life insurance companies by the Reconstruction Finance Corporation. Figures on borrowings of life insurance companies alone are not available for the period preceding July 21 but the total loans authorized to all types of insurance carriers aggregated on July 31 but $65,329,927, of which only three-fourths had been withdrawn. From August 1 to October 31, 26 loans were authorized to 22 life insurance companies for a total of $5,432,700, or slightly less than a quarter of a million dollars per company. These loans ranged between $9,500 and $1,000,000, and were made principally to small companies, only 5 of the 22 borrowing companies having more than fifty millions of insurance in force. Total admitted assets of the 22 companies borrowing during this three months' period were approximately 1.25 per cent of admitted assets for all American companies, and the combined loans represented an amount less than 2 per cent of the combined assets of the borrowing companies. When these figures are compared with the billions which have been paid out in cash by life insurance companies during the past three years, the R.F.C. aid to the companies is seen to be quite negligible.

The problem of lapsation is not due solely to the inability of policyholders to carry their insurance through troublous times nor is that of surrender due entirely to the need for cash. There has unfortunately been a tendency on the part of certain agents to encourage unnecessary lapsation and surrenders, especially on policies encumbered with loans, merely because these offer the possibility of writing new insurance on which new first year commissions will be paid.

Forces as powerful and far-reaching as those which have been enumerated, when coupled with increased taxation and decreased investment earnings, will necessarily influence life insurance costs; directly with non-participating companies by bringing higher rates, and indirectly with participating companies through reduced dividends. Rates have already been revised by some companies, and a large number have announced general downward revisions of dividend scales.

G. F. Michelbacher.—Insurance works as follows: Policies are written,

premiums are collected, losses and expenses are paid, provision is made in the form of reserves against deferred liabilities: then a balance is struck between premiums on the one hand and losses, expenses, and reserves on the other. If something remains of the premiums after losses, expenses, and reserves have been accounted for, an underwriting profit may be said to have been earned. If losses, expenses, and reserves exceed premiums, the carrier has sustained an underwriting loss. Fundamentally, the problem is just as simple as that. It requires only a speaking acquaintance with mathematics to establish the conditions under which this simple formula may be expected to produce a certain result.

A constant struggle is waged to maintain conditions which will insure a slight margin of profit to the carrier. But periodically, in spite of everything that can be done, the delicate adjustment which normally prevails is disturbed and it is unfortunately true that when this happens, a loss is far more likely to be experienced than a profit.

Such a disturbance occurred during the depression and it has left its mark upon every department of the insurance business. The characteristic reactions were, first, a reduction in premium income, second, either an increase in losses or a decrease which was proportionately less than that sustained by the premium account, thus raising the loss ratio and, third, a dislocation of the relationship between expenses and premiums resulting in a higher expense ratio. Increase both loss and expense ratios and the slight margin of profit which is earned in normal times rapidly shrinks to zero or a minus quantity. Accelerate the process and a sea of red ink begins to spread over the horizon as far as the eye can reach. When this happens, the insurance business may expect to be confronted with one of the tests that have established it as the most effective shock absorber ever devised by man.

Fire premiums showed a reduction of approximately 12 per cent from 1930 to 1931. Losses were approximately 9 per cent less in 1931 than in 1930. The result was an increase in loss ratio from 54.7 per cent to 56.3 per cent.

This large reduction in fire premiums may be attributed to reduced rates, the decrease in new building construction, the decline in inventories due to hand to mouth buying policies, and a general wave of discontinued policies due to inability to pay premiums.

On the expense side of the ledger the situation was somewhat similar to that on the loss side. Expenses were reduced in dollars and cents but not in the same degree as premiums; an increased expense ratio was the result. Three large expense items have played havoc with attempts to reduce expenses as rapidly as income; fire prevention work must be continued, taxes are reduced very little, and salaries cannot be readjusted overnight.

Passing on to the underwriting experience of casualty companies, we find in the published statements of the sixty-two leading stock companies a decline of only 5 per cent in earned premiums from 1930 to 1931. The reports seem to indicate that the underwriting loss increased from $26,000,000 in 1930 to $31,000,000 in 1931.

Casualty premiums will naturally experience a considerable decline in those forms which base the premiums upon factors seriously affected by the depression; e.g., pay rolls. The depression has witnessed more burglary loss at a time when it is difficult to increase premiums.

Incidentally, the depression has treated the legal profession rather badly if we are to judge by the increased resort to needless insurance litigation. The companies are justified in protesting against the strict legal regulation of the casualty business.

A word of explanation regarding the extraordinary losses in bonding lines may not be out of place. The real sources of many of the recent troubles in the field of suretyship were localized in point of time before rather than after the beginning of the depression. The depression aggravated these pre-existing conditions and serious trouble resulted. A few examples may be cited. The frenzy of speculation which swept this country during the bull market caused more than one person occupying a position of trust to "borrow" money that was not rightfully his. Everyone was "in the market" and everyone was getting rich. The money would double or treble in no time and it could then be returned with no one the wiser. A sure thing if there ever was one! Many were tempted and could not resist temptation. Money was embezzled, securities or real estate were bought on margin, deal after deal was successfully negotiated—and then the market broke! As values collapsed, the scheme by which the deception was practiced could no longer be concealed. The result was exposure and a claim against the bonding company under a fidelity bond or some form of blanket bond. There were, of course, other causes for fidelity and blanket bond claims, but speculation in one form or another undoubtedly accounted largely for the abnormal losses of the recent period.

In conclusion, just a word about the future. Insurance executives have not placidly accepted the conditions of the last few years. They have waged a determined struggle to improve the position of the carriers and to reorganize methods and programs for the future. Where rates have been shown to be inadequate, steps have been taken to increase them. Underwriting policies have been readjusted to conform with the new conditions; a general housecleaning of undesirable and unprofitable sources of business and risks has been prosecuted and more conservative programs have been adopted for new commitments. Economy has been practiced with vigor—salaries have been reduced, personnel has been curtailed, new methods have been devised for more efficiently performing necessary functions, extravagances of all kinds have been discontinued, a ban has been put upon unprofitable production efforts. Individual carriers in some cases have been liquidated; others have been merged; others have been reinsured in part. A determined effort has been made to combat crime rings guilty of arson, the prosecution of false claims, and similar activities. No item of losses or expenses has been immune from executive scrutiny and adjustment. The result is bound to be beneficial in the long run.

It may be said then that the business of fire and casualty insurance and suretyship is pursuing the even tenor of its way, fulfilling its obligations

faithfully, taking its losses philosophically, meeting its responsibilities courageously, and revising its policies and practices so that they will conform to the new order of things which we all hope is now emerging from the chaos of the depression.

E. L. Bowers.—The cash demands made upon the life companies both in respect to policy loans and surrenders as well as in meeting contract obligations have been exceedingly heavy. For the three-year period now closing, payments on death claims to estates or beneficiaries amounted to $2,227,622,000 and cash payments to living policy holders accounted for $4,912,434,000, a total cash outlay of $7,140,056,000, a sum equal to about one-third of total assets. Policy loans and surrender values comprised over 56 per cent of the total disbursements.

During the same period the cash income of the companies amounted to $11,320,830,000, of which 78 per cent came from premium payments and 22 per cent from interest, dividends, and rents. Thus, a total of over $4,180,000,000 was available for expenses and investment. The actual investment operations, however, were much larger than this sum indicates. Through the sale, redemption, or maturing of securities and the sale of real estate the companies received $3,479,762,000; through investment and reinvestment they acquired capital items amounting to $7,771,465,000.

Distribution of Investments

Principal United States Legal Reserve Life Insurance Companies

	Investment portfolio at end of 1929	New investments made during		
	%	1930 %	1931 %	1932 %
Farm Mortgage Loans	14.1	10.0	7.6	9.6
City Mortgage Loans	39.4	45.0	36.5	31.8
Railway Bonds and Stocks	22.4	10.0	10.4	1.0
Public Utility Bonds and Stocks	11.7	15.9	21.4	10.1
Miscellaneous Bonds and Stocks	3.1	8.8	5.0	4.9
U. S. Government Bonds	2.4	3.1	6.7	19.0
State, County and Municipal Bonds	3.8	4.5	9.8	14.8
Canadian Government Bonds	2.8	2.6	3.4	3.7
Other Foreign Government Bonds	.3	.1	.2	5.1
Total	100.0%	100.0%	100.0%	100.0%

It is evident that the companies have made concessions in the interest of liquidity, without, at the same time, sacrificing too much in interest return. Mortgages, a non-liquid but relatively high yield investment, and government and municipal bonds, a liquid but relatively low yield investment, are now of approximately equal importance in new investment distribution and together comprise over four-fifths of total investments. With a few exceptions those companies with the largest proportion of farm mortgages have encountered the most difficulty, the amount of mortgages in arrears ranging from 15 per cent to 20 per cent of mortgages held.

United States government bonds have undergone the greatest change of any of the new investments of the past three years. At the end of 1929 the Federals comprised only 2.4 per cent of total investments, advanced to 3.1 per cent in 1930's new investments, jumped to 6.7 per cent in 1931, and

soared to 19 per cent in 1932 placements, an increase of 691 per cent in three years.

This tremendous increase in total government bond purchases, now amounting to nearly 43 per cent of all new investments, indicates that the companies are vitally interested in security and liquidity, and as far as the latter is concerned, this practice stands out in marked contrast to that of previous years.

Policy and premium loans and lapses constitute the principal investment problem of the depression. Without them, as was once the case, the companies could weather a prolonged depression with little difficulty. These privileges, the legal rights of the policy holder, have transformed life insurance companies into demand paying institutions, and have exposed them to all the problems which "cash over the counter" demands. Suppose this depression had been more severe than it has been to date, or suppose it had been of longer duration, would the time not have come when the companies would have had to sell bonds at prices below the amortised values, and stocks below the "commissioner's" values, and foreclosed real estate below the amount of unpaid principal plus foreclosure and interest charges, and real estate mortgages below their current listing? The spread between income and disbursements has steadily narrowed since 1928, the income dropping from 147 per cent of disbursement in that year to 113 per cent at the close of 1931. True, there was a gross surplus of nearly two billion dollars at the beginning of 1932, only a minor part of which was in cash. To convert the balance would have entailed loss.

To date the companies have met their cash demands. They have done everything that their sixty-five million contracts could demand of them. And they have done it with very little assistance. The Reconstruction Finance Corporation from February 2 to August 31 authorized loans amounting to slightly over one and a third billion dollars, only 5.3 per cent of which was for insurance companies of all types, the principal potential borrowers being banks and trust companies, building and loan companies, and railroads. The amount loaned to life insurance companies to date is at the outside not more than one dollar for each five hundred dollars of assets when all companies are considered.

Although the situation today is considerably different from what it was in former depressions certain aspects of life insurance experience during the economic disturbances of the seventies and nineties may add something to an understanding of present problems. Real estate foreclosures were more numerous then than now, some of the acquired properties being held by the companies until the turn of the century. During the twenty-year period, 1878 to 1898, real estate always comprised more than 10 per cent of total assets, in some cases contrary to the laws governing investment. Not until after the Armstrong investigation did real estate holdings drop below 6 per cent.

In the depression of 1893, policy loans amounted to only 2 per cent of assets, not because the people did not need them but because they were not obtainable under the contracts, either because the companies were in re-

ceivership or the policies had not yet obtained cash values under the existing laws. The number of life insurance company receiverships today is negligible in contrast with the many failures of the earlier period. All of these things, and in fact almost everything which affects the life insurance business, depend fundamentally upon the future course of business in general.

C. A. Kulp.—There are at least three questions that need to be answered in order to present a statement of the investment experience of insurance companies, in any period. They are: What has been the rate of income earned on their assets? What have been the capital losses or gains? What appear to be the results on the financial condition of the companies, and ultimately on their safety?

The net rates of investment return (Connecticut Reports) from investments (net after deducting investment expense) for the years 1928-31 have been as follows:

	Fire and Marine	Casualty
	(% of admitted assets)	
1928	.035	.036
1929	.036	.036
1930	.042	.039
1931	.042	.039

The outstanding feature of these figures is the fact that both classes of carriers have maintained a higher investment return in the two depression years than before. While it is quite obvious that the high prices of boom years serve to keep down yields, it is just as true that the low prices of depression will produce relatively high investment returns only as long as dividends and interest are paid. Real bargains in yields are not to be had merely for the buying, and to be able to show yields of 4 per cent net in the second full year of a serious depression is at least presumptive proof of sound investment policy. Just why the fire and marine companies show an advantage in investment return, the combinated statistics will not allow us to answer without reservations. It is perhaps significant that the proportion of their assets invested in securities is uniformly higher than for the casualty carriers, particularly in stocks. Both in 1930 and 1931, 39 per cent of fire and marine assets were in stocks; only 22 per cent of casualty. Although it is quite true that stocks as a whole are not depression-proof, those owned by insurance companies are conspicuously of the better grade, principally those of banks, public utilities, and insurance companies. They include also many preferred stocks which maintain dividends longest, and are least disturbing to an investment program. Whether or not there is a direct connection between greater stock holdings and higher investment return cannot of course be shown without more intensive analysis.

But there is the other side of investment experience that must be ascertained in order to gain a rounded picture. It is found in the figures showing net profit and loss on investments. Assets during the year have been sold for more or less than their book value, book values themselves may have been written up or down. The company indeed may be losing on assets at the same time it is gaining on income. To give an idea of their relations to

each other we show figures for net underwriting gain or loss in surplus, and for investment gain or loss in surplus. Both are expressed as per cents of admitted assets:

	Fire and Marine (% of admitted assets)		Casualty	
	Underwriting	*Investment*	*Underwriting*	*Investment*
1928	+.032	+.069	+.015	+.043
1929	+.033	+.016	—.009	+.025
1930	+.021	—.051	—.021	—.0068
1931	+.030	—.100	—.036	—.033

While it is evident that the investment results for the casualty companies are not as serious as for fire and marine, the former for the last three years have had no underwriting gains on which to fall back. Instead underwriting has been an important source of loss. While the fire and marine companies show a 10 per cent investment loss in 1931, an underwriting gain of 3 per cent brings total net operating results to a 7 per cent loss on assets; the casualty companies with far better investment results have a total operating loss of practically the same amount. Investments for casualty companies thus present a problem just as serious as for fire and marine companies, although by themselves they have been much more favorable.

The following table indicates policyholders' surplus per dollar of liability. These figures differ from those for surplus only principally for the stock carriers, though a few mutuals have a guaranty capital. The effect of adding capital stock to surplus of course is uniformly to raise the level of safety, but naturally not to change the trend. Comparison of the trends in policyholders' surplus and surplus alone intimates that the major burden of the depression has to date been borne by policyholders through surplus reduction.

DOLLARS OF POLICYHOLDERS' SURPLUS PER DOLLAR OF LIABILITIES

	Fire and Marine			Casualty*		
	All	*Stock*	*Mutual*	*All*	*Stock*	*Mutual*
1928	$1.05	$1.02	$1.34	$ .53	$ .56	$ .30
1929	1.15	1.14	1.33	.52	.55	.28
1930	1.11	1.09	1.24	.47	.47	.28
1931	.75	.73	1.01	.33	.33	.28

* Excluding life companies whose capital and surplus is at joint risk of life and accident business.

From these elementary facts and comments it would be quite possible to create a horrible spectre of instability and fear. Defective as are the figures as far as particular causes are concerned, the financial results of the last years on these insurance companies, particularly of 1930 and 1931, are all too evident and quite beyond dispute. Nevertheless in sober judgment it appears to this commentator that there is no reason forthwith to predict the end of the economic system or of this particular part of it. Any institution which has managed to keep up its admitted assets to within 4 per cent of its 1928 level as the fire and marine companies have, and even to raise them as have the casualty companies, is not yet doomed. The New York Stock Exchange bond average in the four-year period 1928-31 declined 25

per cent, its stock average by nearly 75; yet the number of casualty and fire company failures has been relatively small and not one policyholder has lost a cent of money. The situation is serious, it is critical, but one should not yet call it desperate. Drastic as their experience has been, the record of the property and liability carriers is pre-eminently one, not of weakness, but of unexpected and admirable financial strength.

F. E. Wolfe.—In examining the underwriting experience of fire and casualty companies the New York Insurance Reports indicate the following:

Stock fire insurance companies showed losses respectively in 1930 and 1931 of 2.2 per cent and 4.5 per cent only if figured in relation to premiums written; but if taken on the sound basis of premiums earned, for appraising final results of a particular year, these companies really made underwriting gains in 1930 of 2 per cent and in 1931 of 5.1 per cent.

Casualty companies experienced losses in 1930 of above 6 per cent and in 1931 of 4 per cent of earned premiums; but averaged over the last five years their losses approximated 0.8 per cent.

Surety and fidelity lines were most unprofitable and had losses of 17.1 per cent in 1930 and 28.4 per cent in 1931 in relation to premiums earned.

The fluctuations in the value of insurance stocks show that the 1932 low point of twenty New York City banks was 9.1 per cent of their 1929 high, while that of fire insurance companies was 16.2 per cent and of casualty and surety insurance companies of 8 per cent. This 16.2 per cent compared with 7.5 per cent in the case of railroad stocks and 16 per cent in case of utilities. The December 14 value of fire insurance stocks was 30 per cent of its 1929 high, while the bank stocks were only 14 per cent, and utilities stocks were 25 per cent, and the other groups were lower.

Insurance in all branches of the business, by the tests of (a) stock security valuation and (b) of the number and amount of loans from the Reconstruction Finance Corporation, has so far in the depression maintained in a remarkably acceptable manner its essential quality of dependability. In meeting these tests its record surpasses other leading types of business.

C. L. Parry.—Those who reason that a lower price level will greatly reduce the amount of life insurance in force should consider the following:

The American population is still under-insured (less than $900 per capita). That amount obviously cannot be considered adequate protection. Furthermore, only about five to six cents out of each dollar of national income has been spent in any recent year for the purchase of life insurance. There still exists great room for expansion in insurance sales.

The growing interest of the American population in old-age security, and the manner in which life insurance companies are meeting that need through annuity provisions, etc., will undoubtedly serve to direct the attention of more individuals, as time passes, to the value of life insurance as life insurance. Thus the sale of annuities and of the various forms of regular life insurance which contain a savings element may be expected to bolster the volume of sales, premium income, and amount in force.

Dr. McCahan's data on policy loans during the last three years—$2,048,678,000 in cash and $412,230,000 in premium loans—are for com-

panies holding 86.4 per cent of the assets of all legal reserve companies; the figures would be somewhat larger for all companies.

I should like to add to Dr. Bowers' statement that railroad bonds have become of lesser importance in the life insurance portfolio since 1925; the decline in this type of investment began in 1906.

Low price levels may cause some of the experience of the seventies and eighties to be repeated. Failures among life companies are not likely to become so widespread because they are much older now.

In conclusion it seems to me that if one is disposed to be judicial minded, he cannot arrive at any other conclusion than that life insurance has given an extremely good account of itself during the depression. Less than .5 per cent of total United States legal-reserve life insurance company assets are now involved in any way because of company failure or receivership; probably a less percentage of total legal-reserve life insurance in force has become so affected, after three years of unprecedented business conditions.

SESSION ON RESERVES FOR UNEMPLOYMENT INSURANCE

SOME THEORETICAL ASPECTS OF UNEMPLOYMENT RESERVES

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The unemployment problem is so pressing and our understanding of it so imperfect that discussion and experimentation must go hand in hand. Economic theory alone can never lead to settled conclusions on questions of economic policy, and in the present state of the economic theory of unemployment and of business cycles much of the analysis can be but fragmentary and tentative. Imperfect though it is, theoretical analysis can anticipate some of the results of experiments. We are not reduced to a simple trial and error basis. We can see lines along which experiments are well worth while and other lines along which experiments, however noble in purpose, are not worth undertaking. It is well that this is so, for we cannot afford free experimentation. An unsuccessful experiment always has after-effects which cannot be eliminated by the repeal of a statute and which may sometimes turn out to be incurable diseases which cannot be checked once they have had a good start. American students find much to criticize in European systems of unemployment reserves, but the European states, far from being able to discard their present systems, have great difficulty in checking conspicuous abuses. American students of unemployment reserves are particularly interested in two problems: maximizing unemployment prevention and avoiding a mixture of unemployment reserves and poor relief. The present discussion deals with the theoretical aspects of these problems.

The topic to be discussed first is the incidence of employers' contributions. If unemployment reserves are built up even in part by levies upon employers, who really pays the bill? Do the employers assume the burden, or do they shift it forward to the consumers or backward to the wage earners? The burden rests eventually upon the wage earners. The employer's contributions are roughly proportionate to his pay roll or the size of his work-force. They amount to an increase in his labor costs. So long as wage rates are not reduced, the employer will seek to economize on the relatively dear factor of production and save labor to the utmost. Employers' contributions are unlike a commodity tax, for a tax furnishes no incentive to substitute one method of production for another. In any normal case, the employers cannot, either singly or in concert, raise the price without encountering some loss in volume, without reducing some equipment and some labor to idleness. To regain the volume,

to put the equipment and labor back to work, costs must be reduced, and the pressure will be concentrated upon the labor costs. Wage rates will be cut.

Almost all economists who have examined the question of the shifting of employers' contributions have reached the same conclusion. It is, of course, subject to many qualifications. In periods when the trend of prices is upward and wage rates lag behind prices, employers' contributions may not result in an actual reduction of wages. At the present time, we are in no such period. Contributions of any significant amount to unemployment reserves cannot now be levied upon employers without adding to the pressure on wage rates. There is a further qualification: the pressure on labor costs may either add to unemployment or decrease wage rates. The existence of unemployment benefits may make it more likely that unemployment will be increased and less likely that wage rates will be cut. Further qualifications may be introduced when other collateral effects of reserves, such as their effect on trade unionism, are brought into the discussion. Time does not permit a more elaborate explanation or justification of the conclusion that employers' contributions are shifted backward to the wage earners. Most of this paper deals with the consequences of this tendency.

Two conclusions of practical importance may be stated at this point. First, employers' contributions do not constitute a burden on industry. They would constitute a burden if the other claims on industry remained intact, but they are nothing but a form of labor compensation. This is true, of course, only in the long run; but institutions like unemployment reserves, which are more than temporary emergency expedients, have to be examined with a long view. Employers' contributions might not be a burden, even if unemployment reserves are on a company or state basis instead of a national basis. There is the possibility that workmen will find a system of partially deferred compensation as acceptable as the existing wage system. Corporations have found systems of deferred compensation—reserves for dividends—more attractive to investors than paying out all profits immediately. If a system of deferred wage payment proved to be as satisfactory, there would be no burden on industry even if the plan was not universal. Second, contributions from employers are to be discussed as political and administrative expedients. The justice of asking workmen to pay for unemployment benefits and the adequacy of their means to do so have nothing to do with this question. If it is considered unjust or impracticable to have the workmen bear the burden, unemployment benefits must come from the public treasury.

In the discussion of the first topic, the problem of incidence, the assumption was made that contributions to unemployment reserves are a real burden to somebody. Actually we should examine the question,

and our second topic is whether unemployment benefits will pay for themselves.

A system of reserves which would maintain both the physique and the morale of the unemployed not only would meet a great human need but also would constitute an important national asset. Such a system would be an advantage to all employers, and particularly to those small employers who could not set up a system for themselves, even if they had the foresight and the financial resources. This advantage to employers would help them to pay higher wages or carry the burden of the system. On the other hand, it is probable that any considerable amount of unemployment would reduce the workmen's productive power, even if they received unemployment benefits. Much of the loss in the workmen's industrial efficiency comes from unemployment itself, whether benefits are paid or not. None the less, if the effects upon the workmen's efficiency were the only considerations, we might conclude that unemployment benefits would pay for themselves to a great extent.

Several economists have expressed the view that the purchasing power made available by unemployment benefits would reduce the severity or duration of business depressions and thus would reduce unemployment. If this were true, the benefits would help, in another way, to pay for themselves. However, inasmuch as economists have been unable to arrive at any adequate explanation of the business cycle in general and of business revival in particular, the effects of this purchasing power may be analyzed only tentatively. Even as tentative analysis this view is unacceptable.

No one will question, of course, that an increased flow of consumers' purchasing power is a phase of business revival. If this is based upon a resumption of business activity and an increase in employment, it will encourage activity in industries producing other than consumers' goods. Benefits from an exhaustible reserve, accompanied by continuing unemployment, can do nothing to stimulate the revival of business confidence.

A second point for criticism is the neglect of the difficult transfer problem. How can an unemployment reserve turn its assets into cash without adding to financial strain and unemployment? A simple transfer of purchasing power from the buyers of the reserve securities will not add to the total. An addition to purchasing power might come through the use of bank credit; but throughout most of a depression bank credit is not available in large quantities. Similar difficulties are encountered, of course, in any other attempt to liquidate assets in a depression; but the magnitude of the task of turning virtually all of a huge unemployment reserve into cash during a major depression makes it a different problem from that encountered by insurance companies or by corporations in keeping up dividends.

A third point for criticism is the effect upon the balance of expenditures for producers' and for consumers' goods. Here a further important consequence of the incidence doctrine comes in. Whether contributions are levied upon employers or upon workmen, the effect is to reduce expenditures on consumers' goods in periods of prosperity. The balance between the two forms of expenditure is thus turned even more toward producers' goods. The effect thus is to increase the disproportion which is a dominant factor in some theories of the business cycle and an important factor in all. In a period of depression, likewise, the benefits increase expenditures on consumers' goods when expenditures on producers' goods are too small to provide much employment.

For all these reasons, then, the view that the purchasing power of unemployment benefits will be an aid in maintaining employment overlooks too many important aspects of the cycle to be acceptable. The difficulties of transferring purchasing power from one period to another are very important. If the human needs were not so insistent, we could call the difficulties insurmountable. They reduce the chance that unemployment benefits will pay for themselves. They are so important that unless great skill is used to meet them they will result in an increase in unemployment and in the costs of a reserve system.

The chance that unemployment benefits will pay for themselves depends, further, upon the conditions for benefit. If the benefits are paid, not only when a workman is unemployed because no work can be found at any price, but also when he has refused a job with a substandard wage, the system combines protection against unemployment and protection against wage reductions. This is the system provided in the Wisconsin Act. Other systems have operated in the same way. In such a system there are implicit the views that unemployment is not reduced—is perhaps even increased—by wage reductions or that wage reductions are a greater evil than unemployment. Personally, I find these views entirely unconvincing. I regard wage reductions as the lesser evil and a necessary means to bring about the resumption of employment. Stabilization of wage rates and stabilization of employment are to some extent complementary objectives, but to a larger extent competing objectives. The forces opposing or delaying wage reductions are already strong enough to prevent such a chaos of price and wage reductions that business operations would be impossible. There is no need to add to the already great rigidity of wage rates. In periods and trades where unemployment increases much beyond its minimum amount, maintaining wage rates is not a means to maximize the purchasing power of the wage earners. Less inflexibility would decrease unemployment; more will certainly increase it. In proportion as the modern conscience revolts at the misery of the unemployed, we weaken the principal force driving wage rates down-

ward; and we are bound, in good conscience, to find some other force to prevent the perpetuation of unemployment. Herein lies a principal defect of most unemployment reserves plans, and here is a principal reason for doubting that the reserves will pay for themselves.

It is to be hoped that better reserve systems will do more toward making the reserves pay for themselves. Experience to date does not warrant taking our hopes for facts; unemployment reserves are best considered as devices to spread consuming power through time and not as "productive consumption," a device to eat our cake and have it too.

The belief that contributions from employers will aid materially in reducing unemployment is an argument for unemployment reserves which has been so important in American discussions that it deserves treatment as a special topic. This belief underlies the Wisconsin Act, the first state reserve plan to be adopted in this country. The belief rests upon the diagnosis that employers lack sufficient incentive to stabilize employment and upon the view that contributions from employers will provide the necessary incentive. I have not been converted to this belief.

The diagnosis that unemployment persists because business leaders have no incentive to prevent it is radically defective. Idle labor means idle equipment. Idle labor means less purchasing power. A period of unemployment is a period of business losses and business failures. Entirely apart from any nice pecuniary calculations, the employer, as a human being, would prefer to give a man a job rather than to take one away. The causes for unemployment are to be found, not in inadequate incentives, but in inadequate ability, foresight, knowledge, and control. Most of the causes of serious unemployment lie beyond the immediate control of the individual employer; they are external to the individual establishment. They are economic, social, and political forces. Of course, business men have a large share in the responsibility of all of us as citizens. On this point, it does not become economists to cast the first stone—they have not agreed upon any clear-cut, straightforward program to prevent unemployment. The failures of economists, however, are not attributable to inadequate incentives but to the enormous complexity of the problem. The emphasis on the inadequate incentives of the individual employer to eliminate unemployment is unwarranted.

Even if we make the contrary-to-fact assumption that existing incentives are not sufficient, how will employers' contributions to an unemployment reserve add to an employer's incentives? It would first be necessary to have the employer contribute solely for benefits to his own workmen whom he had let go because of lack of work. This apparently is done in the Wisconsin Act. When the liability is so limited, an employee who quits voluntarily to take a job with another employer loses all claims

on the reserve which he has indirectly built up from his own wages. If the individual employer could do much to prevent unemployment, this restriction on the right to quit might not be too high a price to pay. As the situation stands, it is an intolerable burden.

The proposal to make the support of the wage earners, whether employed or not, a fixed charge on industry is attractive only upon most superficial consideration. Fixed charges are of two sorts. In the first, financial sense, a fixed charge is relatively secure. Some of the capitalists are in a relatively secure position only because other capitalists are more exposed. In a similar manner, some of the wage earners may be put in a relatively secure position if the burden of employment fluctuations is concentrated upon men not admitted to the ranks of "regular" employees. This is the effect of some guaranteed work plans. All workmen or all capitalists cannot be in a relatively secure position. In the second, cost-accounting sense, a fixed charge is a fixed and specialized form of capital and cannot escape when the demand for its services declines. Immobility is its essential characteristic. Workmen will not gain by being made more dependent upon the sales of a particular establishment than they are already.

The possibility that the employer's contributions will be an additional stimulus to him to reduce unemployment is practically eliminated by the shifting of the burden to the wage earners. If the contributions are precisely balanced by a reduction of wage rates, the employer has no reason to change his practice of hiring and firing. Some small incentive could be added if the employer were fined a large lump sum every time he let a man go. This would make the employer unwilling to take a man on unless he expected to give him work for a considerable period. It would amount to a prohibition of casual labor. When, however, the employer's contributions and liabilities are proportionate to the length of employment, there is no prohibition of casual employment. The Wisconsin Act provides that the liabilities shall be proportionate to the length of employment and so gives no significant incentive to stabilize. Any plan at best could help toward evening out the minor irregularities of employment. No plan could help in the most serious forms of unemployment, technological and cyclical. An understanding of the incidence problem is a death blow to the faith in additional incentives.

An understanding of the incidence problem is an important aid, further, in explaining the ineradicable instability of unemployment reserves based upon the "insurance" or pooling principle. If unemployment were an insurable risk, a workman would pay directly or indirectly the cost of the risk of unemployment to a homogeneous class of men whose chances were no better or no worse than his own. Insurance depends upon the grouping of like risks and upon appropriate differences in premiums and

benefits between several classes. The average risk has to be for a homogeneous class. An average risk of unemployment calculated for a heterogeneous class of workmen in highly secure and highly insecure positions is no basis for insurance. Moreover, an average calculated upon past experience is no help unless the experience warrants our projecting the average into the future. This is not the case. The British and the German miners did not expect any such unemployment as that existing in recent years; and no one foresaw, five years ago, the problems we are now facing. The average percentage of unemployment due to minor irregularities can be calculated, but this type of unemployment has little effect upon superior workmen. Cyclical unemployment and technological unemployment, which hit good and bad alike, are incalculable. Unemployment is no more insurable than business failure.

A pooled reserve, whether on a geographical, trade, industry, or individual establishment basis, lumps together good and bad risks. Under such a plan, the less exposed workman pays an excess and the more exposed workman receives an excess. The more exposed workman receives a benefit which has been paid for in part by himself and in part by other workmen. In other words, his benefit includes some relief. The element of relief in the benefits paid from the unemployment reserve is thus not dependent upon grants from the public treasury or upon benefits extended beyond the contractual limits but is inherent in the pooling basis. The charitable character may be disguised, but it is evident in the departure from the *quid pro quo* basis.

When, and if, the less exposed workmen penetrate the disguise, they may well ask why they are compelled to pay a special tax for unemployment relief. If they are bound to the unemployed by a strong sentiment of solidarity, they may be entirely willing to pay the tax. Such a sentiment may be found in some trade union and company plans. But the sentiment of solidarity is weakened whenever there is considerable shifting in and out of the group. The instability of industry thus works against effective solidarity.

Moreover, the instability of industry makes a definition of membership in the group uncertain. Whether eligibility for benefits is defined in terms of length of employment, duration of unemployment, or ratio of benefits to contributions, the same definition of the eligible group will include, in good times, those with slight claims to membership and will exclude, in bad times, those with strong claims to membership. Suppose, for example, that eligibility is limited to those who had four months of employment in the preceding year. This would include a very large number in a period of prosperity and might exclude, in a period of depression, workmen who had spent most of their lives in the industry. When the group is ill defined, solidarity is weakened. The weakened solidarity

which is inherent in a pooled reserve in an unstable world will result in demands that the public treasury support the unemployed through other taxes or will result in a low level of contributions and hence inadequate benefits.

If unemployment reserves are to eliminate all traces of relief, the only possible basis is that of deposits or savings. If an unemployed wage earner could draw only the amount deposited in his individual account, the individualist *quid pro quo* principle would be adhered to strictly. Individualists, at least, would probably be willing to pay higher contributions. The same system could well be used to build up a fund for retirement and old age. The rigidity of wage rates—which is a principal obstacle to the reduction of unemployment—might not be increased when the workman realized that he and no one else was paying his unemployment benefits, that he was drawing on his own reserves. If the rate of contribution was raised to include provision for old age, the larger income in bad times would render the problem of liquidating assets to obtain cash much less acute. The deposit or savings basis for unemployment and old age benefits is simply an extension of the method of providing for those contingencies which is already practiced by both wage earners and investors.

Such a system of deposits or savings obviously would not provide for all the unemployed for whom, on economic and other grounds, something better than existing methods of public and private aid is desired. This is true also of a reserve system on the pooled or insurance basis. Under either system, workmen who have exhausted their claims to benefits cannot be classed with the unemployable or chronically poor. Mrs. Sidney Webb traces many of the difficulties of the British system, particularly the overload of additional relief, to the failure to provide a second line of defense behind the insurance system. The British public had been warned of this necessity in the report of the Poor Law Commission before the original act was adopted. The American public needs the same warning now. All provision for the unemployed cannot come from a system of reserves. Any system of reserves, moreover, will be of little aid in solving the major problem of prevention.

THE ECONOMICS OF UNEMPLOYMENT RELIEF

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Professor Meriam has given reasons for believing that the provision of unemployment reserves will do little to stabilize industry. The reasons he gives, however, lead also to the conclusion that unemployment is likely to be a recurrent evil, partly because of our imperfect knowledge of economic sequences, and partly because of the prevalent unwillingness to accept the sacrifices which a far-reaching stabilization policy would involve. Provision for those whose income has ceased because of unemployment will constitute a major problem of practical economics for many years to come. I propose, therefore, in this paper to accept that fact as basic and to discuss the economic considerations which must be kept in view in providing relief for the unemployed, and to analyze, by reference to these considerations, proposals for the establishment of unemployment reserves or insurance funds.

Current controversy reflects at least four prevailing views concerning the requirements of a system of unemployment relief. In the first place, it is very generally held that the scheme should be designed to reduce the volume of unemployment. In so far as this requirement implies that the relief system should be used as a method of introducing order into the labor market by providing for the registration of claimants to benefit at public offices, at which also information concerning jobs is centralized, there can be little disagreement. Experience shows that public unemployment offices have not been very effective in the absence of positive inducements to report to them, but also that such offices can conveniently check the genuineness of claims for unemployment relief, in view of their centralized knowledge of both offers of work and demands for labor. Obviously, however, enforced attendance at employment offices cannot create jobs. It can merely enable the unemployed to find existing jobs more quickly, and can facilitate the collection of essential statistics without which no rational attack on the problem of unemployment is conceivable.

The demand that the cost of unemployment relief should be distributed in such a manner as to force employers to stabilize their demand for labor is more far-reaching, but since it has been discussed at considerable length by Professor Meriam, I propose to do no more than express my general agreement with the view that the possibilities in this direction have undoubtedly been overestimated. The amount of unemployment that is within the control of individual employers or even industries is less than is often assumed, and until the incidence of contributions required from employers has been more clearly traced, the extent

to which such contributions stimulate reorganization rather than efforts to shift the burden to workers, consumers, and landlords must remain in doubt. It is undeniable, however, that some pressure can be successfully applied.

In the third place it is held that unemployment relief should be used to eliminate unemployment by transferring purchasing power from good to bad times. This claim appears in the form of proposals that expenditure on public works should be controlled to compensate changes in the private demand for labor, and less frequently, that reserve or insurance funds should be accumulated over a period of time and distributed in emergencies. Concerning such proposals, I wish to add but one or two footnotes to Professor Meriam's remarks. Laying aside reserves of commodities at one time which can be used later to supply the needs of the unemployed without depriving other members of the community of resources at that future date, is, of course, possible only if a central authority buys actual goods and puts them in storage, or if it invests current unemployment reserves outside the given economic unit and is able to realize them in periods of unemployment without disturbing the home economy or depressing the investment market.

It can be conceded at once that the accumulation of internal investment reserves in prosperity and their disbursement in times of serious depression necessitates realization of property at an unfavorable time. Even so, Drs. Shoup and Shere have recently shown that apart from exceptional circumstances, a state as a seller might profit financially from the relative increase in bond prices during trade depressions.[1] But there is no reason why reserves should be treated in the period of accumulation as ordinary savings and allowed to stimulate production. It is undoubtedly possible to accumulate purchasing power in periods of good trade in the form of an earmarked reserve of cash or deposits and to provide for its automatic disbursement when unemployment appears. Such a policy would avoid the undue stimulation of productive activity in the upswing of a cycle, such as Professor Meriam fears. Indeed, it would normally retard business expansion in times of prosperity, since it would slow down the circulation of money in the widest sense, unless the financial authorities decreased their reserve requirements in a corresponding degree. But it is more probable that the presence of a growing earmarked reserve, liable, if needed at all, to be withdrawn rather rapidly, would lead in a rational banking system to a cautious policy and thus to some restriction of expansion. The disbursement of the fund would, other things being equal, have an inflationary effect. Most attempts at inflation tend to be ineffective in depressions, because purchasing power is

[1] Memorandum No. 11, *N.Y. State Commission for the Revision of the Tax Laws*, p. 6.

offered to producers, who at such times are influenced less by lower interest rates than by an assurance of markets, or to bankers, who use new funds for strengthening their reserve position rather than for oiling the wheels of trade. But the distribution direct to the unemployed of the fund accumulated for that purpose will more effectively stimulate production, since it makes purchasing power available to those who by definition will be certain to spend it. Actually, however, it is probable that this inflationary effect would be neutralized by the already existing restriction of lending by banks and by the unwillingness of business men to borrow from banks, which constitutes one of the phenomena of depression. Given declining business activity, such a payment to the unemployed tends to bring about, as compared with the period immediately prior to the depression, a transference of purchasing power from buyers of producers' goods as a group to consumers. Whether or not this transfer is desirable depends, of course, upon the causes of the trade cycle. I suggest that present knowledge gives no basis for condemning it.

Even if the distribution of the earmarked reserve more than balances the contraction of the activities of banks and business men in the investment field and thus involves some measure of inflation, the stimulation of consumption is subject to obvious safeguards. On the one hand the amount that is to be distributed is narrowly limited by the low level of income represented by the amount of the benefit, and, on the other hand, the duration of the distribution is limited by the fact that as unemployment diminishes, the inflationary tendency automatically ceases to operate. The provision of such funds, therefore, may be claimed to be a safer form of inflation than the facilitation of advances to producers, for the latter involves a real danger that prices will continue to increase long after available resources are being worked to capacity.

The real question, therefore, is not whether assured payments to the unemployed can be made from reserves without reducing the funds available for production in depression or unduly increasing them in prosperity. There are, rather, two questions: firstly, whether it is desirable at some periods to change the balance of purchasing power in favor of consumers' expenditure, and secondly, whether the best means of doing so is to issue fiat money in times of depression or to provide during prosperity for an orderly contraction of the circulating medium in the widest sense, by requiring regular contributions from industry, the fund thus accumulated being used in times of bad trade to pay weekly benefits. The answer to the first question turns, as I have said, upon our theory of the causes of the trade cycle. Later in this paper I will suggest a tentative answer to the second question.

The second frequently expressed requirement of an unemployment relief system maintains that it should provide some return to society for its

expenditure. Raw materials and capital should be provided so that the unemployed may make some return for the income they receive. This argument underlies proposals for the development of public or private works in time of depression; it finds expression also in proposals such as that of Mr. G. D. H. Cole that the unemployed should be organized in a labor army and set to work upon tasks of general social benefit. Finally, it underlies in part the proposals put forward in Great Britain originally by Lord Melchett and developed on a spectacular scale in Germany in the recent measures of the Von Papen government, that unemployment relief should be paid not to the unemployed but to employers, to induce them to take on workers who would otherwise have been regarded as submarginal.

The argument is seductive, but reflection suggests both theoretical and practical limitations. With the obvious practical economic difficulties of subsidizing the wages paid by private employers I do not propose to deal. I desire rather to examine the implication that apart from these difficulties the economic advantageousness of such a scheme is incontestable. In the first place, setting the unemployed to work in this way necessarily involves an expenditure considerably greater than would be required merely to maintain them. Experience indicates that the payment to the workers relieved must approximate more closely to the current rates of wages than must bare relief grants, if only because persons at work need more food and clothing than those who are idle. In any case, additional expenditure to provide capital and materials with which to carry on the work is necessary. The economic advantageousness of this type of attack on the unemployment situation turns, therefore, upon a choice not between a given expenditure which will yield something and the same expenditure yielding nothing, but between a given expenditure which will yield nothing and a somewhat larger expenditure which will yield some economic return. In making this choice, the satisfactions which could have been obtained from the expenditure of the additional fund in the course of ordinary business must be compared with those obtainable by utilizing the labor of the otherwise unemployed.

In other words, a problem of comparing marginal utilities arises, and it is far from certain that the worthwhileness of expenditure on productive relief will be obvious. In so far as the unemployed can be put to work which involves the utilization of machinery and resources otherwise remaining idle, or can in this way be obtained at less than the current rates paid for labor, the economic return obtainable from the stimulation of this kind of employment might be expected to compare favorably with that obtained from stimulating employment through the normal channels of consumer demand. Unfortunately, however, the benefits available from this source are less than they seem. Firstly, there is a

tendency everywhere observable for expenditure of this kind to be directed toward the employment of as large a number of workers as possible and therefore to the stimulation of employments that involve a relatively small amount of capital. Secondly, as already pointed out, physical necessity plus pressure from labor groups has tended to reduce the differential between the remuneration paid for this relief work and that for work in unsubsidized employment.

Moreover, the choice between allocating a given sum to maintenance alone or a larger sum to maintenance that will yield some economic return cannot be made without regard for the kind of product yielded by subsidized employment. In the absence of profitability as a criterion for determining the kind of work to be undertaken, safeguards have in fact been established which have severely restricted the type of work subsidized. Specifically, subsidies have been restricted to production shown to be additional to what would occur, and also to be socially desirable. The experience of Germany has illustrated very clearly the practical difficulties of distinguishing work that is additional to what would have been normally undertaken, and there as elsewhere there has been a tendency to limit subsidized employment to works which would not be economically remunerative to any individual employer or local authority but which might benefit the community as a whole over a long period of time.

Thus the net advantage of allocating additonal funds to relief in order to obtain something instead of nothing from unemployed persons will then turn upon the source from which these other funds come. If they are raised out of general taxation collected from those who would otherwise have spent those funds, the worthwhileness of this stimulation involves a decision that present consumption shall be restricted in order to secure productive works bringing in a return many years hence. The poorer the community, the less desirable is such redistribution of resources likely to appear. If, however, the funds are raised by taxation from those who would otherwise have saved, or is financed by the floating of loans, the net economic desirability depends upon the extent to which these funds would otherwise have been used to stimulate production through the normal channels of industry. Only where they would otherwise have remained as idle deposits does the decision to use them for productive unemployment relief avoid the choice between present and future satisfactions to which I have already referred.

It is important, however, to note that although the economic advantageousness of productive unemployment relief may be less than appears at first sight, it may nevertheless be desirable because of its effect upon the morale of the workers. The important question is, then, whether the community can afford to pay this price for maintaining morale and

whether it is possible by this means to care for all the unemployed. The practical difficulties have been sufficient in almost all the countries in which this experiment has been tried to limit additional payments to relatively short periods of time and to a small proportion of unemployed persons. As unemployment has increased, the willingness to incur this additional expenditure has been less and less in evidence.

The third requirement frequently made of unemployment relief systems is that they shall not aggravate the existing situation through their effect upon workers, employers, or the government. This requirement underlies the common objection to unemployment relief systems that they tend to maintain wages and, therefore, to postpone essential economic readjustments. This view has been prominently associated with the name of M. Rueff, who has endeavored to establish a statistical relationship of this kind in regard to the British situation. For various reasons, largely of a technical nature and which I have set out elsewhere,[2] I do not think that M. Rueff has established his argument.

The fact remains, however, that there is an undoubted relationship between wages and unemployment relief wherever loss of income is relied upon to bring about economic readjustment. If workers are persuaded by loss of income to offer to do the kinds of work in demand at the price which society is prepared to pay, any relaxation of that pressure (such as would result from the guarantee of a fixed unemployment payment) must postpone economic revaluation. A guarantee of a fixed relief payment for a defined period must thus be regarded as an expression of the willingness of a society to allow the displaced worker a breathing space before forcing him to make serious economic readjustments.

Many economic reasons can be urged in favor of this guarantee. It is obviously wasteful to have too high a degree of adaptability on the part of workers. Changes in demand may be merely temporary and it is unnecessary for employees to acquire other skills or to force their way into other occupations, if the demand for services of the type they have formerly performed is likely to revive within a relatively short period. It has long been observed that the opposition of organized workers to the introduction of new devices and their attitude to increased production has been connected with their fear of loss of income due to unemployment. More recently Mr. Matthewson has shown in an admirable study[3]

[2] *Labour Magazine*, August, 1931, p. 182; cf. also F. Brown in *New Statesman and Nation*, June 20, 1931. Apart from serious statistical flaws, the most important gap in Rueff's argument is his failure to demonstrate that it is the unemployment insurance system which has been responsible for the remarkable post-war stability of wage rates in Great Britain. I suspect that the marked lag between movements in the general level of retail and wholesale prices in a country where wages are very largely regulated by collective bargaining or by state-enforced wages boards is more responsible for this rigidity of wage rates than is generally supposed.

[3] S. B. Matthewson, *Restriction of Output, passim.*

that fear of unemployment leads also to restriction of output by unorganized workers. A society such as ours which encourages changes in productive technique and sets a high value on the freedom of the consumer to change his mind cannot afford, in the interests of adaptability of labor supply, to concentrate the costs of innovation upon displaced workers and thereby obstruct change.

Finally, our knowledge of the relationship between sustained consumption and regularity of production, especially at the beginning of a trade depression, is not yet sufficiently definite to permit a positive assertion that a revision of all existing money contracts, involving *inter alia* reductions of wages, is an essential prerequisite to the restoration of economic balance. The risk of maintaining wages for a limited time at the beginning of a depression when the basic reasons for maladjustments are obscure may be worth running. But it should be noted that no society can relinquish the right periodically to revise the duration of the period for which it will run that risk in the light of more exact knowledge of economic relationships, changes in the general level of prices, and changes in the real economic income of the community.

The claim that an assured unemployment payment discourages mobility as between occupations, when it is not a special case of the theory we have just discussed, has validity only when unemployment relief is provided for some and not all of the occupations in a given economic area. It is undeniable that in Great Britain the exclusion of agricultural work and domestic service from the provision of the unemployment insurance system has tended to discourage entry into these occupations where it has not positively encouraged exit from them. It is in other words an argument against a partial unemployment relief system.

Unemployment relief may, it is also said, aggravate the existing situation through its effect upon employers. Firstly, it is argued that the knowledge that their workers will be cared for encourages carelessness in discharge policy. It is, of course, possible that the knowledge that discharge may mean starvation to their workers may induce employers to make special efforts to postpone discharge and to ration work among their existing staff. This argument is most plausible where there is a close personal relationship between employers and workers, but it is doubtful whether even then it has wide validity. Moreover, some methods of raising funds for unemployment relief offer a safeguard against this danger by a provision for the levying of increased contributions from industries where gross carelessness in employment policy is demonstrated.

A second and more serious charge is that unemployment relief financed by contributions from industry defers revival if it does not actually aggravate depression. The correctness of this argument depends upon

the cause of unemployment. Where unemployment in some sections of industry is attributable to a change in taste or knowledge which redounds to the advantage of other sections, there is a clear economic case for charging the cost of unemployment in the former against the latter; the cost of transferring workers from the depressed industry and maintaining them during transference is part of the final cost of the new product or process. Assessment against the beneficiary industries insures a closer approximation to the economic ideal that so far as possible selling prices should reflect all the costs involved in the production of a commodity.

But where unemployment is more general or assumes the catastrophic proportions with which we have recently become familiar, it has been held by such authorities as Mr. Keynes[4] that raising funds from industry depresses enterprise more than if a similar sum were collected from general taxation. Here, too, any certain answer awaits the final development of the theory of incidence, but even if it were known that the incidence of industrial contributions fell directly or ultimately upon the employer, the effect on enterprise is still in doubt. It is true that competition from producers not subject to the charge might have serious consequences, although on account of the protective tariff this factor necessarily assumes negligible importance in this country as compared, for example, with Great Britain. But in the last resort, the answer depends upon our theory of the elasticity of demand for income in terms of effort. Once again, I suggest that current economic theory supplies no certain answer. Finally, it should be noted that the claim has validity only if certain types of taxation are adopted, and in this country it is by no means obvious that the attempt to raise at least part of the funds by direct contributions from industry would depress enterprise more than the collection of a similar sum by the traditional indirect methods of taxation, in which the sales tax appears likely to play a prominent rôle.

In the third place, it is claimed, some forms of unemployment relief aggravate depression because they have an adverse effect upon government policy. This view has been strongly put by Sir William Beveridge, who has suggested that what he regards as the unlimited benefit has paralyzed governmental attempts to improve the economic situation in Great Britain.[5] It is, of course, conceivable that payment of practically unconditional relief from general taxation might diminish the pressure exerted upon the government by a desperate incomeless electorate to initiate economic reorganization, but the practical validity of the argument

[4] In the *Political Quarterly*, January, 1930, p. 119, ff.
[5] W. H. Beveridge, *Unemployment* (1930), p. 409; cf. also evidence of Sir William before the Unemployment Insurance Commission.

is far from clear. No state has made more positive efforts to create employment than Germany, where there also exists the most comprehensive system of unemployment relief; and the absence of adequate and orderly provision for relieving the unemployed in the United States cannot be said to have justified itself by inducing great measures of constructive economic statesmanship. Indeed, it seems more reasonable to expect that when the costs are concentrated and known, as occurs when relief is financed through general taxation or industrially supplied reserves, the cost of continuous unemployment is more likely to stimulate demands for economic reconstruction than where the burden is incapable of measurement because diffused among the unemployed, their friends and relatives, charitable individuals, landlords, and storekeepers incurring bad debts.

The fourth requirement concerning the characteristics of an ideal unemployment relief system holds that it should at least protect those footing the bill by setting a limit to their liability. This view expresses itself in the demand that proposed insurance or reserve schemes should be financially solvent, and in the constant preoccupation with the financial aspects of unemployment relief in all countries. Efforts have been made to limit the cost of relief by various devices. Care is taken to see that payment is made only to those genuinely unemployed and limits are placed upon the duration and amount of benefit, and these are sometimes subject to revision as the unemployment relief fund shrinks. It is important to note, however, that although the expenditure to be incurred in any period in respect of any individual worker can be limited, it is impossible to limit the total liability for relief expenditure. Restriction of the duration of benefit limits the total liability only when the turnover of personnel in the unemployed class can be accurately estimated and remains unchanged. Furthermore, limitation of total liability requires foreknowledge of the total number of persons qualifying for and claiming benefit, and experience has revealed the difficulty of making such forecasts. Moreover, financial burden is significant only in relation to the total available income against which it is assessed. Circumstances which bring about a marked change in the proportion of claimants to potential payers or a decline in the general level of money incomes will change the real burden of any given total monetary liability for unemployment relief. Finally, it must again be emphasized that the solvency of insurance or relief funds can be attained and the interests of contributors (through taxation or otherwise) protected, only at the cost of failure to provide for all cases of need. In other words, unless incomeless persons are to be denied consumable goods, safeguards merely transfer the cost of maintenance from one fund to another. In both England since 1931 and Germany for a much longer period, the safeguarded insurance funds have come to provide for a diminishing propor-

tion of the total numbers of the unemployed. In England, the insurance system now meets the needs of less than 50 per cent of all unemployed persons.[6] In Germany the corresponding proportion in October, 1932, was 11.4 per cent.[7]

Thus of the four characteristics commonly demanded in an ideal unemployment relief system, two—the claim that it should eliminate unemployment, and that it should give the contributors something for their money—prove on analysis to be less economically seductive than appeared at first sight. Furthermore, all known schemes which aim at these objectives have been shown by experience to be capable of dealing with little more than the fringe of the relief problem. On the other hand, my analysis suggests that although in some respects expenditure on unemployment relief yields a positive economic return, there is a margin of risk involving an uncompensated economic cost which cannot be avoided and which is only in part represented by a financial burden.

Above all we must realize that there is no single and more or less automatic way in which society can limit its risk and at the same time provide for those who are incomeless through unemployment. Any sound attack upon the problem must accept from the first the fact that there are two problems and not one. One concerns the determination of the cost to be incurred both in terms of measurable money burden and in the broader economic sense. The other concerns the method of financing. These overlap at some points but are in the main distinct.

A solution of the first problem involves the necessity of making periodic judgments concerning the amount of unemployment that the community is prepared to undertake responsibility for, and the duration of the period within which no pressure will be applied to the unemployed to readjust their economic valuations. In making this decision the question of the relationship of the probable total financial cost to the anticipated money income of the community necessarily plays a part, but the more fundamental economic costs of unemployment relief to which attention has already been drawn in this paper must also be taken into account. In any case it is a problem that must be solved by reference to broader criteria than the financial state of any specific industry, reserve, or insurance fund. In the last resort the decision is only partly economic, for the determination to shoulder certain economic costs, when they cannot be shown to involve any economic return, is an ethical decision. But it is obviously economically undesirable to fix once and for all the standard which any society will guarantee and the period for which the guarantee is to run.

From this point of view the attempt to provide adequate relief on the

[6] *Ministry of Labour Gazette*, December, 1932, pp. 471, 472, and 474.

[7] *Wirtschaft und Statistik*, I, November, Heft, 1932, p. 672.

principle of insurance with its emphasis upon a fixed benefit conditional on the payment of defined premiums breaks down, not merely because it is impossible to forecast the total amount of unemployment. Even the attempt to insure over long periods of time for an extremely high potential unemployment relief demand is objectionable, for, since the money amount to be provided and the duration and conditions of benefit can never be decided once and for all, but must vary with economic conditions and the probable causes of the depression at any given time, it is impossible to know many years beforehand what total money sum to provide for and therefore what average yearly contribution to assess. Moreover, unemployment insurance, which aims to provide a certain physical standard of living, differs from life insurance where the contract runs only in money terms and where there is no pressure on the insuring agent subsequently to adjust his benefits to changes in the purchasing power of money. Furthermore, the worker who has contributed over several years in the expectation of receiving a defined benefit may well feel a sense of grievance if the actual rate paid in periods of depression amounts to appreciably less than this, when other workers whose claims fell in different years but who had contributed on the same basis received a higher sum.

And if it be argued that premiums should be changed from year to year in accordance with the change in probable expenditure, then it can be objected that years of heavy unemployment are precisely times when the imposition of additional burdens on industries is likely to have the most disadvantageous effects.

But it is also true that unemployment exhibits certain characteristics in common with risks against which it is possible to insure. In particular it is important to note that any given percentage of unemployment is not distributed equally among all workers. In Great Britain a recent investigation has shown that no less than 35.2 per cent of the persons continuously insured during the 7¼ years between 1923 and 1930 had drawn no benefit at all and another 38 per cent had received benefit for less than 10 per cent of the time, despite an average unemployment rate of 13 per cent, which at times rose as high as 20 per cent.[8] It follows that the attempt to meet the costs of unemployment relief by providing for a separate fund for each worker against which only he can draw involves an unnecessarily large reduction in current spendable income, since much of this reserve is unlikely to be called upon but is not available for assisting other workers.

The second problem, that of raising the necessary funds, can be solved by reference to no obviously appropriate principles, but must be regarded as an ordinary problem in public finance. Basically, we have to

[8] *Royal Commission on Unemployment Insurance, Final Report,* 1932, p. 73.

provide funds to meet an expenditure whose maximum within any given period is incapable of exact forecast but whose minimum can be estimated with considerable safety. The funds, like other taxation, must be raised in such a way that their collection will be most certain and likely to cause a minimum of harm, and even, with luck, some positive good.

From this point of view, there is much to be said in favor of raising a proportion of the funds by what is in effect a tax upon industry in the form of contributions from employers and employees, with a provision that the state shall make good any deficit that occurs within a given financial year. In so far as the sum provided by industry was in excess of the requirements of any year it could constitute a reserve fund which would postpone the necessity of imposing an exceptionally heavy direct burden on industry in periods of depression. The general case in favor of providing for some measure of stabilization of public revenues from year to year to meet irregularly recurring expenditure has been ably put by Professor Haig and his associates in recent reports to the New York State Commission for the Revision of Tax Laws, and need not be elaborated here.

But in the second place, if what I have said concerning the stabilizing effects of an earmarked reserve has any validity, this method of providing for at least part of the funds would introduce a factor tending to mitigate the severity of upward and downward movements of trade. Even more directly, the decision to provide some considerable proportion of the funds in this way makes possible the adjustment of the tax to meet the special circumstances of highly seasonal trades and the exertion of pressure on individual industries where management can be shown to be responsible for irregularity. So long as there is any chance that measures of this kind would encourage stabilization, we cannot afford to neglect them.

Finally, the collection of part of the funds from workers makes possible a classification of the unemployed which has both economic and social advantages. We have seen that society cannot afford to make a fixed payment to all incomeless persons for an indefinite period. To confine the right to draw unconditional benefit for the period which society has at any time guaranteed to those who have been shown, by virtue of their past payments of the tax, to be regularly employed persons, and to concentrate the examination into financial circumstances and pressure to revise economic valuations on those who cannot fulfill this qualification or who have been out of work for longer than the period of the guarantee, is perhaps as satisfactory a solution of the essential compromise between the economic interests of society and of the individual as we can hope for. On the one hand, it avoids the costly and inconvenient administrative necessity of undertaking a detailed investi-

gation into the circumstances of every unemployed worker. On the other hand, it permits a considerable proportion of the unemployed, particularly in normal times, to be dealt with in a manner that preserves their self-respect. They receive preferential treatment for the guaranteed period because they have paid a part of the cost.

Only by sharply separating the decision concerning the economic cost that society is prepared to pay in relieving unemployment, from that concerning appropriate methods of raising the funds may we hope on the one hand to avoid fundamentally irrelevant charges of a lack of financial solvency, and on the other to preserve a freedom to adjust the amount and duration of benefit in accordance with the periodically observed economic interests of society, without causing contributors to feel that they have been swindled by a breach of contract or to become pauperized by the receipt of indiscriminate relief.

DISCUSSION

David A. McCabe.—I agree with Professor Meriam and Dr. Burns that the economic effects of the establishment of a system of unemployment reserves, whether pooled or separate, will be found more in the sphere of relief than in that of prevention of unemployment. As for their respective reasons, I find myself more in accord with Mrs. Burns than with Professor Meriam.

Professor Meriam seems to base his conclusions largely on the assumption that the employer's contributions will be shifted back to the workers in wage reductions or in the foregoing of advances that would otherwise be won—where the workers do not take the burden in reduced employment directly. I understand the a priori reasoning behind that thesis, but I am not convinced of the validity of the general assumption that in our complex economic system the employer's contributions would be recouped from wages, if the plan were compulsory and universal—not confined to a few states. There might be some readjustment of the numbers employed, as between particular industries or services. It may be, too, that in some seasonal industries wage rates have been so nearly adjusted to seasonality, on a comparative basis, that a compulsory levy of high rates of contribution to provide additional compensation for seasonality would be passed back on to the wage rates, in part at least. But I query whether it would be true in general that wage rates would be reduced in a measure equal to the employer's contributions. I think we need more confirmation from experience with the workings of the plan before taking that assumption as the foundation of our reasoning as to the further effects.

Without accepting Professor Meriam's assumption that the premiums will exert no pressure on the employer to stabilize employment, I agree that the preventive effect has been exaggerated in some quarters—for good strategic reasons, no doubt. The argument seems to have little validity in the case of unemployment due to technological changes or to apparently permanent decline in the demand for particular products. The problem here is not so much one of prevention in the first instance as of compensation and economic rehabilitation. Indeed, it calls for a different kind of treatment than the provisions of the ordinary reserve or unemployment insurance plan contemplate.

It is in seasonal industries that the argument for putting financial pressure on the employer to stabilize would seem to have most weight—if the premium rates are high and are not shifted backward on wages in accordance with the hypothesis considered above. But seasonal unemployment is not the kind that is uppermost in the argument for unemployment reserves or unemployment insurance in this country today. In fact, there is good ground for believing that it should be separately dealt with, so as not to impede concentration of premiums in a reserve for unemployment due to a general depression. And even in the case of seasonal industries, the pressure of the employer's contributions in the direction of prevention must be balanced against other costs of such varying magnitude that, although its influence cannot be ignored, it cannot be assumed that it will prove generally the controlling factor.

On the question whether "the transfer of purchasing power" from the period of prosperity to the apparent onset of the downward swing would exert a stabilizing effect, I would sharpen one point. How much effect would "the release of purchasing power" have if producers are fearful that a reduction in prices and costs is inevitable? Would it have much appreciable effect in keeping up employment in the important group of industries concerned with the production of producer's goods? Would it reduce in any important degree the total of unemployment experienced between the beginning and the end of the depression, if the depression is not to be ended without important readjustments? Considering the full run of the depression period, I confess that I do not think we are yet in a position to claim confidently very much for it as a factor of prevention, if recovery must wait upon price readjustments.

Finally, on the question whether the payment of unemployment benefits would not postpone recovery, and so prolong unemployment, by retarding wage reductions, if and when wage reductions are a necessary part of the readjustment demanded, such evidence as we have from experience seems to favor the affirmative. This is not necessarily a condemnation of unemployment reserves or insurance. I am heartily in agreement with Mrs. Burns in her statement that there are ethical questions involved. But I am wondering whether we must postulate that workers will not take wage reductions so long as they have unemployment benefits to fall back upon, even if wage reductions should be a practically necessary condition of increased employment under the economic system prevailing in this country.

Is it not possible that readjustment of wage rates may be considered by the wage earners—and their advisers—on its merits as a possible method of increasing employment and earnings, independently of the existence or nonexistence of unemployment reserves? I grant that it is difficult to tell in the early stages of a depression whether it is practicable to count on recovery within a short time without wage reductions. And I am far from holding that precipitate and undiscriminating onslaughts on wage rates are the beginning of wisdom in the economics of combating depression. But I am asking whether we must assume that resistance to wage reductions must necessarily be a concomitant of receipt of unemployment benefits? Cannot unemployment reserves from within industry itself be made a means of subsistence during the period of readjustment, or a part of it? Why must we assume that such readjustment must wait until the reserves are exhausted, leaving the workers largely to other forms of relief until production revives on the new level? I am confident that something can be done to secure in practice a handling of the wage question on a timing basis all its own and therefore quite distinct from the relative degree of exhaustion of the unemployment reserves.

Warren B. Catlin.—In the brief time at my disposal, I shall confine myself mainly to Professor Meriam's paper, which I happened to see first, and leave to others the treatment of Dr. Burns' brilliant exposition of the principles of relief.

There are two possible methods of considering and meeting a theoretical

argument. One is to try to drag it down to earth and then to challenge it on the ground of its impracticability. This is a favorite device of our business friends but ought not to be necessary for economists themselves. The other method is to attempt also to soar aloft into the ethereal realms and to carry on the combat in the same element from which it was started. Judging from the arrangement of the program, it is this second form of attack that is expected in this discussion.

The crux of Professor Meriam's argument and the reason why he believes that any scheme of unemployment reserves that rests upon contributions from employers in whole or in part will defeat its own end, create unemployment rather than diminish it, is obviously to be found in the doctrine of "shifting and incidence" to which he referred at the beginning. We shall, therefore, make no progress and enjoy no peace and comfort unless and until that ghost is laid and laid forever. Owing, doubtless, to their respect for the classical unities and to the limitations of time and space, neither of our speakers has undertaken to conduct our wayward and perhaps weary minds through all of the intricacies of this most difficult and often baffling branch of economics which has thus been carried over from the realm of taxation and somewhat ruthlessly applied to unemployment problems.

Professor Meriam is largely content, by way of proof of his assertion, to state that "almost all economists who have examined the question of the shifting of employers' contributions have reached the same conclusion"; that is, that they are ultimately shifted to labor itself and come out of wages. Who are these economists and what are their reasoning processes? In his admirable review of recent literature on unemployment in the *Quarterly Journal* for November, 1931, Professor Meriam also touches rather lightly upon this same problem and in this connection gives high praise to an article by Mr. Dale Yoder of the State University of Iowa in an earlier number of the *Q.J.E.* Tracing that down we find that Mr. Yoder likewise attempts no thorough examination of the circumstances affecting the shifting and incidence of employers' contributions but quotes as his chief authority Professor Harry Gunnison Brown of the University of Missouri in his book on the *Economics of Taxation*.[1]

I am not disposed to break lances with any of these gentlemen. Those of us who received our training in the mysteries of the subject of "shifting and incidence" under Professor Seligman may, however, feel justified in questioning whether the matter can be dealt with in any such simple and summary fashion. There are at least ten different factors which affect the ability and the disposition to shift a tax and, presumably, an insurance premium: whether it is large or small; whether it is general or special; whether it rests upon profits and surplus or upon the marginal producer; whether the demand for the commodity is elastic or inelastic; whether it is produced under the law of constant, of increasing, or of decreasing costs, and so on. The profitableness or unprofitableness of the whole discussion is perhaps indicated by the fact that both Professor Brown who is cited by Mr. Yoder,

[1] Dale Yoder, "Some Economic Implications of Unemployment Insurance," *Quarterly Jour. of Economics*, XLV (1930-31), 622-639.

who is in turn commended by Dr. Meriam, and Professor Taussig, whom Professor Brown, in turn, cites as giving qualified approval to his theories of shifting, are none the less strong advocates of a broad program of social insurance which would presumably include that against unemployment.[2] May we not agree once and for all that social legislation, as its name implies, is passed for the benefit of society and not for any one group; and that, whoever pays for it in the last analysis, it is preferable to chaos and disorder? The strongest argument for some form of unemployment insurance or reserves is that it promises not only to safeguard labor from some of the worst consequences of involuntary idleness but to furnish an orderly substitute for the random and uncertain relief campaigns and proposals with which we are now harassed.

But I do wish before leaving this topic to point out a possible flaw in Professor Meriam's reasoning which is apparently accepted by his fellow conspirators. His assumption and that of Professor Brown is that the insurance premiums concerned are "imposed upon employees not in proportion to output or to sales but according to the number and wages of workers hired" (Brown, p. 163). Initially and superficially this may seem to be true in the case of both workmen's compensation and the unemployment reserves plan, but it does not remain so long. In both cases the basis of premiums or payments soon comes to be, not the number of wage earners or the amount of their wages, but the probabilities of risk in the particular plant or industry, in the one case of accidents and in the other of unemployment. To confine ourselves to unemployment, under the Wisconsin plan, as soon as the employer has paid in a certain sum, say $75 for each workman, he is not called upon for any more payments until this fund has become depleted through unemployment benefits. It is distinctly a contingent or a conditional liability, not a regular tax, and the presumption is that, at least so far as some forms and causes of unemployment are concerned, the employer or a group of associated employers have considerable power to evade or avoid the expense through regularization and greater conservatism in expansion and changes in equipment. The levy held over their heads thus becomes an unmistakable incentive to reform and to win an advantage over competitors.

We have, in fact, always assumed that the close parallelism between the history of the safety movement in American industry and the progress of workmen's compensation legislation—both dating from about 1911—is ample proof of such a preventive effect operating through the merit ratings given by insurance companies. That could hardly be if the entire burden of the payments is shifted back upon the workers.

But Professor Meriam will say that the analogy between workmen's compensation and unemployment reserves, or between accidents and unemploy-

[2] Professor Brown says (p. 174): "But to say that the burden of the premium paid for workmen's insurance falls ultimately upon wage-earners as such, is not to question the desirability of such insurance. Insurance, as is well known, is a pooling of risks. All bear a little loss in order that none may suffer the extreme loss," etc. Professor Taussig says (vol. ii, p. 356): "Obviously it is no objection to an insurance system that the premiums ultimately come from the beneficiaries themselves."

ment, is imperfect and that it is difficult to derive one from the other. It is true that the burden of unemployment is much greater than that of industrial accidents, for even in our most bloody and reckless years we probably do not injure much over 2,000,000 workers, and fortunately a large proportion of these injuries are slight and involve little loss of time, whereas even in normally prosperous years the number of unemployed seldom falls below 1,500,000 day in and day out, and in periods of depression like the present as many as 11,000,000 are estimated to be out of work for months. Furthermore, as has been stated, the control which the individual employer is able to exercise over accidents within his own plant is much greater than his control over many of the causes of unemployment which may be world-wide. The employer is, indeed, the primary risk-taker but he cannot be expected to assume all of this responsibility. Professor Meriam also contends that in so far as the employer does have control and power to prevent irregularity of employment he already has sufficient incentive to use it because his capital is idle as well as labor.

Let it be freely granted that for both unemployment and industrial accidents nothing short of divine wisdom could fairly apportion responsibility. We know, however, that it is divided upon some basis among all the parties concerned in industry. Labor itself cannot shirk all blame for unemployment and its evil effects until it makes the wisest possible choice of occupation and cultivates full versatility; unless it shows proper loyalty and willingness to co-operate with willing employers in making the business efficient and successful; and unless it manifests the spirit of foresight and thrift in the management of its private affairs. We talk a great deal in the labor problem about the need of security. But too much security, as Dr. Meriam has suggested, is just what is not good for most of us. It is for this reason and for the maintenance of a fair measure of self-respect that I should support a plan of unemployment reserves which calls for some direct contributions from employees. We can style it "compulsory saving" if we wish, and certainly it will result in securing more liberal benefit provisions than can now be expected from any system in which all contributions are to come from employers.

It is, however, a case not of the employer paying less but the employee paying more. The employer should if possible be made to see that his employees, depending somewhat on the skill and loyalty which they have shown, have some vested rights in the industry as well as he, and that they should not be turned off at will when they become too old or when some change in process or contraction of business makes their services no longer necessary. If he thinks he needs a reserve army of labor at the gate awaiting his beck and call he should be ready to pay for it whether idle or busy. "They also serve who only stand and wait." I suppose we shall not be able to decide who is responsible for the mania for style and fashion and for the seasonal trades to which it so largely gives rise. It may be due to human nature, especially feminine human nature. The disparity of wealth and income and the conspicuous consumption which it prompts undoubtedly have something to do with it. High pressure salesmanship and advertising,

in turn, bring the responsibility close home to business itself. Style goods usually do bring somewhat higher prices so long as they are in vogue and thus enable the employer to pay somewhat higher wages during the active seasons. But organization is usually necessary to compel him to do so. For this type of unemployment, therefore, prompt payment of benefits is less necessary or the contributions required of employees themselves might be larger.

For cyclical unemployment our whole planless, competitive system is the chief culprit; and we may well despair of anything more than palliatives so long as it continues. But "disordered finance, prostrate commerce, and ruined credit," as Daniel Webster would say, have played their part; and the government, in addition to establishing or at least assisting in the conduct of a well co-ordinated scheme of employment exchanges to bring jobs and idle men together when both exist, can do something to remove the fundamental causes of unemployment by giving us a sounder and more stable credit and currency system and by adopting policies respecting international trade and finance that will promote rather than hinder commerce and the growth of good-will. After the hopeless policy of tinkering and tampering with the unemployment insurance system that has been followed by a succession of British ministries in the past twelve years and the high voltage of disrepute which has been generated by the "dole," I doubt whether any American legislature can be persuaded to adopt a scheme of unemployment insurance that involves payments from our depleted public treasuries. And such direct subsidies are probably not desirable anyhow.

When we come to technological unemployment, however—that new name for an old form—I feel that the employer again has a large measure of responsibility. With regard to this there is not, for a long time, at any rate, that complete identity of interest between capital and labor which Professor Meriam has postulated. Capital may here be more fully and efficiently employed at the same time that a considerable number of workers are displaced and compelled to look for other jobs wherever they may. Here is where a dismissal wage or insurance payment thrown into the scale can perhaps do most to compel the employer to make technological changes with sufficient forethought and deliberation to permit of readjustment and relocation for the victims of progress.

British experience which we are now citing perhaps more often as a terrible example of what not to do rather than as one for imitation, does not, however, according to his own admission, bear out Professor Meriam's dire predictions respecting the depressing effect of unemployment insurance upon wage rates. According to Professor Bowley's figures, real wages per week in Great Britain have increased 17 per cent during the period from 1913 to 1929—a period practically contemporary with the existence of the unemployment insurance system. Professor Clay, and Mr. Rowe in his book on *Wages*, attribute this stabilizing effect in the face of changes in the cost of living to the improved bargaining position given to labor by insurance benefits. We may agree that this stabilization has been carried to excess and that in both American and Great Britain business recovery might have been

hastened if deflation had occurred all along the line at the same time, both prices and wages being more promptly reduced and a new start being made from the new level as soon as everyone became convinced that the bottom had been reached. But it will be difficult to convince labor that the maintenance of wage rates is not desirable even though recovery may be delayed and unemployment prolonged. This arises chiefly from their belief that wage rates are more likely to be flexible downward than they are upward. If there were some guarantee that readjustments would be more automatic and just, as soon as prosperity and higher prices returned, labor would undoubtedly be more amenable to reason in this matter. It involves something of a wrench in one's inner consciousness to be asked to surrender the old argument that unemployment insurance will help to safeguard labor against the wholesale reduction in wages that used to occur during periods of depression.

The logic of some such provision as is here proposed for overcoming the worst consequences of unemployment seems irresistible and might almost be reduced to syllogistic form:

(1) Unemployment is a genuine risk and involves an enormous waste which ought to be prevented so far as possible and whose results should be mitigated, whether we call the plan adopted "insurance," "reserves," or by some other name.

(2) Individuals or even considerable groups of individuals have not in the past proved able to safeguard themselves from it and are not likely to be able to do so in the future.

(3) Voluntary plans for unemployment benefits, whether adopted by employers alone or jointly with labor organizations, while they are helpful as experiments or examples of what may be done, are purely fractional in their coverage and are apparently not destined to become contagious.

(4) The cost of unemployment relief, whether in the form of charity or of expenditure for public work that we probably do not need and cannot well afford, is not a legitimate charge upon the taxpayers. In so far as unemployment is unavoidable it becomes a part of the cost of production and should be paid ultimately by the consumer of the goods along with other costs.

(5) Charity for those who are able and willing to work is at best a back-handed and back-door method of tiding people over a crisis, cripples our finances, deprives other worthy causes like education and the church of their customary and much-needed support, and tends to promote pauperism and panhandling.

(6) What we need, therefore, is some farsighted program, general and inclusive enough to secure the protection and efficiency which comes with numbers and to avoid placing individual employers or industries at an undue disadvantage in competition, yet close and personal enough (perhaps through a merit rating) to bring the problem home to each party or individual able to do anything to solve it and to give them a powerful incentive to regularize their own industries and employment. Neither of these is a

complete and final remedy; but because we cannot do everything is no reason why we should take a supine attitude and do nothing.

Either a plan of unemployment reserves or one of unemployment insurance will help to break that vicious circle of planless management, irregular work, fear, loss of purchasing power, and more unemployment from which we have been suffering. Either one is a step in the right direction and it becomes only a question of how rapidly and how far we are willing to go. This much is certain, that we shall learn a great deal about it as we go along. If unemployment is not now capable of statistical treatment and of reasonably accurate prediction, it may become so after some years of experience. If it is true that western civilization cannot survive another great war, it may also be true that unless we do something now our cherished institutions may not be able to withstand another depression like the present.

Paul H. Douglas.—I should like first to discuss Mr. Meriam's contention that a system of unemployment insurance would still further accentuate the disparity between the production of producers' goods and consumers' goods during periods of prosperity, disorganize the bond market by the forced liquidation of securities during periods of depression, and fail in general to produce at such times the additional monetary purchasing power which will aid in lessening the depression.

Mr. Meriam assumes that the funds invested in periods of prosperity by the unemployment insurance funds and drawn from the diminished consumption of the workers would be entirely invested in government bonds and would thus release equal quantities of liquid funds for other forms of investment. This would be partially true if the governmental authorities displayed the same complete lack of intelligence which Mr. Meriam assumes, although even here the decline in the demand for consumers' goods would interpose some check upon the quantity of producers' goods which would be demanded while a wise open market and rediscount policy on the part of the Federal Reserve Board would also restrain undue expansion. But with a little foresight there would be no necessity that what Mr. Meriam fears should occur. A part of the unemployment reserves accumulated during the period of prosperity could and should be impounded in the form of gold and removed from circulation by depositing it in the vaults of the Federal Reserve banks and arranging that it should not be used to increase the cash balances or deposits of any bank. This would of course decrease the capacity of banks to expand their loans. Since the volume of credit which is created is from eight to ten times its gold base, it would only require the sterilization of from 10 to 12.5 per cent of the unemployment reserves to neutralize the maximum effect which the accumulation of such reserves might have in stimulating the development of capital goods. Any portion of the reserve which was sterilized above these amounts would therefore exercise a net restraint upon loans and hence upon the volume of investment in capital goods. If as much as one-quarter of the reserves were to be neutralized in this fashion, then there would be a very distinct check imposed upon the loans for the purpose of producing capital goods. It is true that such a

policy as this would involve the loss of interest on the funds thus withdrawn from circulation. But the unemployment insurance funds should not be run as a purely commercial enterprise. They should instead be managed so as to take their part in the interwoven set of institutions and policies which are needed to help diminish business depressions.

Mr. Meriam is also, in my opinion, much too fearful and too literal about the effect which the liquidation of these reserves would have upon the bond market. Even if the bonds were to be sold in the open market, the extraordinary degree to which recent government issues have been oversubscribed would indicate that the banks, whose reserves are certainly ample at such times, would be far more willing to absorb them with their unutilized funds than many would have us believe. But here again there would be no necessity for such open market sales actually taking place. The amounts impounded in the sterilized deposits could be paid out first. Then all that would be needed in the case of the government bonds would be a slight amendment to the Federal Reserve Act which would permit the insurance funds to deposit them with the Federal Reserve banks and receive in return either a loan or Federal Reserve notes. These sums would then be paid out in benefits which would directly increase the monetary purchasing power of the unemployed and build up the demand for consumers' goods and hence in part for producers' goods as well. This, if we may judge from experience, would tend to be a far more effective policy for the Federal Reserve banks to pursue during a depression than open market operations with the banks. For the net result of the policy of purchasing government bonds from the banks seems merely to have been to increase the cash reserves of the banks and this does not stimulate industry unless it results in increased loans which thus far at least, it certainly has not done. The policy here advocated however, would directly put monetary purchasing power into the pockets of people who otherwise would not have it and hence would constitute a force for recovery. The fallacy in Mr. Meriam's analysis seems to be that he assumes the monetary purchasing power to be at any one time a fixed quantity incapable of addition or diminution. Instead of that it is a variable which can be altered under different systems of control.

The conclusion would seem clear therefore that unemployment insurance, in addition to providing a better flow of income through time, and a pooled protection against risk, can also be used under proper management to lessen the violence of business fluctuations and hence provide a net stabilizing effect. But it is obvious that this can be done far more effectively if there is one pooled reserve for a state than if there are a multitude of separate and sovereign plant funds. It is along these lines that unemployment insurance can be of the most aid in decreasing unemployment, and I agree with both Mr. Meriam and Mrs. Burns that the added stimulus given to individual plants to stabilize will not be great.

There is a further way, however, in which unemployment insurance will probably tend to lessen business depressions and that is the stimulus which it will give to greater spending by those who continue to be employed. It was a familiar fact during the first year and a half of the depression that

savings bank deposits were increasing. This was in part due of course to the transfer of funds from more speculative purposes. But it was due also to the fact that when men see their fellows losing their jobs all about them, they realize that the blow may fall upon them at any moment and that if and when it does the only protection which they will have will be their individual savings buttressed by public and private charity. They therefore necessarily cut down on their expenditures and put more money into the banks in a frantic effort to accumulate as large a stake as possible. Now this would cause no harm if the world behaved as most of us were taught and in turn taught others. For the deposits flowing into banks were presumed to flow majestically and synchronously out in the form of investments. The demand for consumers' goods was, it was true, decreased but the demand for producers' goods was commensurately increased so that the workers displaced from the former occupations were presumed to find their place in the latter. But this naïve view has been well exposed by Wicksell and Keynes. As they have well shown, during periods of depression banks decrease their investments. The increased savings move therefore into the banks and are in large part immobilized there without getting out into circulation again as investments. The demand for consumers' goods is decreased and unemployment is created, but there is no commensurate creation of employment in the capital-producing industries. The provision of self-respecting unemployment benefits would diminish the fears which the employed workers would entertain towards the prospect of unemployment and hence would lessen their frantic personal savings at such times and increase the amount which they would spend upon current consumers' goods. There would thus be a better balance between spending and saving and less unemployment would be created than is the case at present.

There is a final point which I should like to touch upon which concerns the relation of adequate relief to insurance. If the unemployed when they have exhausted their maximum period of insurance benefit are then thrown back upon such humiliating, inadequate, and uncertain forms of charitable relief as are granted today, there will inevitably be a tendency to prolong the period of benefit so as to spare the workers from this experience for as long as possible. There will therefore be a danger that the insurance funds will become fiscally insolvent. This would not be so great a calamity as letting the unemployed suffer but it should, if possible, be guarded against. The best way of protecting the fiscal solvency of the system would be to build up reserves of adequate relief which may buttress the front-line trench of insurance. The experience of England and Germany indicates that these should be of a dual character: (a) a period of emergency benefits, paid for in large part by federal grants, which would carry those in need for from thirteen to twenty additional weeks; these sums should be paid out through the insurance machinery but they should not be automatic amounts but should instead be graduated according to the need of the recipients as determined by local committees; (b) after this period, the unemployed who were in need should be transferred to outright poor relief which, however, should be far more adequately financed than now.

The federal government should build up funds during periods of prosperity both for such purposes as these and for a program of public works through earmarking a part of the income taxes on the upper brackets and instituting a tax upon the excess profits of corporations. Since the vast majority of these funds would otherwise be invested in capital plant, there would not be, even with the very worst handling of these funds, any appreciable net increase in the amounts invested. The impounding of even a small proportion of these sums in sterilized cash reserves would therefore impart a net stabilizing influence. Then during the period of the depression, the creation of additional monetary purchasing power, in the fashion which I have already indicated for unemployment insurance, would certainly build up both the demand for consumers' and for producers' goods with the result that the amount of unemployment would be directly lessened. I may say also that our past failure to accumulate such a reserve does not free us from the soundness of such expenditures during the present depression. I would as a matter of fact favor liberal expenditures for these purposes to be met from a bond issue or a guarded issuance of Federal Reserve notes to be retired later when the period of depression is over and when governmental receipts once again exceed expenditures. All this would be in conformity with what seems to me to be the sound principle that while the government budget should balance over the period of the major cycle as a whole, there is no reason why it should balance in each and every year. The expenditures by the government should as a matter of fact move in an opposite direction from those of private business, expanding as the latter contracts and contracting as the latter expands.

SESSION ON STABILIZATION OF INDUSTRIES

STABILIZATION OF THE OIL INDUSTRY: ITS ECONOMIC AND LEGAL ASPECTS

By George Ward Stocking
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Perplexed by the paradox of plenty, distressed by the realities of widespread want and acute suffering, harassed by the shrinkage of national income and the decline in general property values, confused by the failure of individualistic business control to assure stability to our economic mechanism, the business leader and the social philosopher are demanding industrial planning as a way out of the morass in which we are now floundering. Both have become doubtful of the adequacy of the invisible controls upon which we have hitherto so generally relied. Both have pointed the way out of our present economic confusion through the avenue of specific programs of social economic planning. As these general programs have been developed, some representing wide departures from our traditional controls, at least one industry with resort only to institutional equipment of the traditional sort has proceeded with the task of setting its own house in order. The American oil industry, we have been told by the Federal Oil Conservation Board in a recent report to the President of the United States, gives indication of being the first basic industry to emerge from the world depression.[1] To what extent, by what means, and with what consequences has this end been achieved?

Before answering these questions, let us give brief consideration to certain geological and economic characteristics of oil production, which have an intimate bearing on the problem of stabilization. As regards the geological character of oil production, it will be remembered that oil is found in subterraneous porous rock formations in intimate association with gas and water. These substances have distributed themselves in their underground reservoir on a basis of their specific gravity and remain in a delicate condition of equilibrium frequently under great pressure. In a typical oil pool, gas is found in the uppermost part of the underground formation, oil beneath the gas, and water under the oil. Such a distribution represents a geological unit. Scientific development of such an oil pool, designed to secure a maximum of oil at a minimum of cost, would take as its point of departure the geological unit—the oil pool. It would endeavor to utilize in the most efficient manner possible the expansion of the gas and the movement of the water as expulsive agents in oil re-

[1] See *Report V of the Federal Oil Conservation Board to the President of the United States*, October, 1932, p. 1.

covery. The customary division of such a geological unit into arbitrary property tracts and their exploitation under a system of competition have constituted the major cause of waste in oil production. Such waste has been on a scale adequate to excite the admiration of the most profligate.[2] It has been a persistent and an almost ubiquitous concomitant of oil field exploitation. Free gas has been permitted to escape unutilized into the atmosphere; gas pressure, the major expulsive force, has been dissipated in an extravagant and reckless manner; and oil fields have been flooded and ruined through the premature encroachment of salt water. For these wastes individuals are not primarily to be blamed. Rather, the system is at fault. These wastes inevitably flow from the competitive mining of a migratory mineral which recognizes no property lines and transgresses the principle of ownership. They are the product of a system of exploitation based on the principle of robbery.

The economic characteristics of oil production grow out of its geological peculiarities. In the first place, the vagaries of chance, not the rational decisions of economic man, are the forces which bring capacity into existence. No modern industry affords such an attractive field for the speculator, the sportsman, the gambler. Although science has contributed much to oil finding, the determination of the precise location of an underground oil pool still remains a matter for the drill. While large companies with their corps of geologists and petroleum engineers are the dominating elements in oil production, the wildcatter in a relentless search for liquid gold remains an essential though a dramatic and disturbing factor. Although the number of wildcat wells drilled bears a direct relation to the price of oil, their economic outcome, whether dry or producing wells, and their initial daily production remain a matter of indeterminable chance. And finally, under a system of competition, once a pool is discovered, whether the result of applied geology and petroleum engineering or the haphazard product of pure speculation, it must be exploited as rapidly as possible. Protective competitive drilling forces an increase in capacity with little regard to the economic condition of the industry.

A second economic characteristic of oil production is that capacity once called into being is driven into complete utilization by the irresistible forces of competition. This is the result of two factors: the fixed character of the investment in oil production, and the migratory nature of the mineral product. Oil production is an industry of relatively large fixed costs. The major investment is made in the process of drilling a well. It is an investment of a highly specialized sort. Once made, it can neither be withdrawn nor utilized for other than the purposes for which

[2] For a more complete discussion of this problem, see G. W. Stocking, *The Oil Industry and the Competitive System* (Boston, 1925), Chaps. VII-X.

originally designed. This economic fact, coupled with the physical and geological character of an oil deposit—the disposition of oil to move through the pores of the underground rock once the equilibrium of the pool has been disturbed by the puncturing drill, and to move without regard to property lines on the surface—necessitates under a competitive régime production at maximum well capacity. As long as a well will flow under its natural pressure, it must be permitted to produce regardless of the price of oil.[3] Any return on the original investment is better than none. Since oil is migratory, should an individual operator choose to curtail or cease production awaiting a better price for the product, it is for the benefit of a competitor on an adjoining tract who will reduce the fugacious mineral to possession. Even in the case of pumping wells, once the pumping facilities have been installed, it pays to operate them at maximum capacity as long as interest on purely liquid capital, which represents but a small part of total investment, can be secured.

In the light of its economic and geological characteristics, then, the oil industry promises to be recurringly plagued with overproduction. Paradoxically, oil may continue to be produced when it does not pay to produce it. The neat principles of theory are borne out by the stubborn facts of history. Despite continuous overproduction during the past decade, the speculative drive has persistently forced new capacity into existence; this has inevitably been translated into increasing annual output in the face of mounting stocks and a sharp downward trend in prices.[4] Chronic or recurring overproduction is a plague to any industry. In the case of oil, by reason of the inelastic character of the demand for its major product, gasoline, the plague is especially virulent. The demand for gasoline is a derivative demand arising from a demand for motor transportation. The consumption of gasoline is apt to be more affected by factors exterior to the industry than by its own price. The condition of roads, the state of the automobile market, the general distribution of purchasing power, the customary habits of the populace—

[3] In a practical way this statement is true. Theoretically, the irreducible minimum income which the operator of a flowing well must receive to insure continued operation must cover operating expenses together with interest on operating capital. But both of these items are relatively insignificant. The major expense would seem to be that of supervision.

[4] Annual domestic output of crude oil increased from 378,367,000 barrels in 1919 to 1,007,323,000 barrels in 1929. Total of all stocks of crude and refined products increased from 196,135,000 barrels in 1919 to 689,166,000 barrels at the end of 1929. The price of 36° gravity Mid-Continent crude reached a peak of $3.50 per barrel in 1920, dropped to $1.50 in the early spring of 1921, and fluctuated within a 33 per cent range of that price until 1926. With a reduction in stocks in 1926 prices rose to $2.29. A sharp increase in output in the latter part of the year and during 1927 broke prices to $1.28, around which level they fluctuated until the downward trend was resumed in 1930. See *Statistical Bulletin*, American Petroleum Institute, March 26, 1931, Form 1 and *The Oil Weekly*, January 31, 1930, pp. 64-65. *Ibid.*, January 29, 1932, p. 42.

these would seem to be the major factors in determining the amount of gasoline consumed at any particular time.[5] Although normal changes in the price of gasoline will not greatly affect its consumption, they will have a serious effect upon the profit possibilities of the industry. Uncontrolled production of a raw material the demand for whose major refined product is inelastic, carries, as is well known, especially disastrous consequences.

These several widespread influences, waste in the production of crude oil, capacity determined by the vagaries of chance, the necessity of utilizing to its fullest extent capacity once brought into existence, the difficulty of increasing total consumption through the avenue of price reduction, have pointed for some time to the establishment of a program of control for the oil industry. Until relatively recently the existence of waste, although a matter of great concern to the conservationists uneasy about the future oil supply, did not greatly trouble the leaders of the industry. Immediately preceding, during, and following the World War, with a rapid expansion in the use of oil-consuming devices, demand ran somewhat ahead of supply. Under these conditions, despite the tremendous burden of unwarranted overhead and the reckless waste of a limited natural resource, the industry prospered. Even then, evidence of its fundamental unsoundness was not lacking. The rugged individualists of the industry, however, looked with suspicion upon the suggestion that anything should be done about it. For long they were content to solve the problem of waste by denying its existence. The industry, fearful of governmental interference, sought to cure itself by the methods of homeopathy. For competitive ills, competitive pills. As late as 1925 we were assured by the Committee of Eleven of the American Petroleum Institute that avoidable waste in the industry had been eliminated; that there was no danger of petroleum shortage in America; that the industry, if left unfettered by restrictive government regulation, would continue to supply the country with petroleum in quantities adequate to meet the essential needs of industry; that, to achieve this end, the industry must be left to the free play of the forces of competition.[6] And that was all.

Eventually mounting stocks and a weakened price structure seem to have raised an honest doubt in the minds of the leaders of the industry as to the efficacy of repeated homeopathic doses of competition as a remedy for its ills. Apparently they were made to see what they previously had denied the existence of—waste in oil production. Light seems

[5] For a more complete discussion of the character of the demand for gasoline, see Stocking, *op. cit.*, pp. 83-84.

[6] See *American Petroleum, Supply and Demand*, a Report to the Board of Directors of the American Petroleum Institute by a Committee of Eleven Members of the Board (New York, 1925) pp. 3-5.

to have dawned as the Greater Seminole field of Oklahoma spouted its flood of oil onto an already distressed industry. In October, 1926, the Greater Seminole field with only 37 wells completed had a daily production of 81,000 barrels. By August 9, 1927, 600 additional wells had been drilled and daily output had increased to 527,400 barrels. Meanwhile the price of 36° gravity Mid-Continent crude had dropped from $2.29 per barrel to $1.28. During this period a system of control of output was developed and applied to the Seminole field. It was a product of economic distress, not of economic statesmanship; it was a measure of desperation, not a manifestation of social vision. It was created, however, in the name of conservation. Since then, under the same banner, the program has been carried steadily forward until by the close of 1931 oil production had been brought under effective control.

The method by which output has been brought into harmony with consumption is known as a program of proration. At the outset the program was voluntary and local in character. It has since become nation-wide in scope and has had the authority of various state conservation agencies thrown behind it. Although its details have differed from time to time and place to place, its basic characteristics have undergone such slight modification that fairly accurate general description is possible. The program as practiced in Texas is typical. Until modified by recent changes it involved the creation of an extralegal, voluntary, central proration committee for the state, composed of representatives of the oil operators, whose function it was to determine the market outlet for crude oil for a specified period of time. This amount, which became known as the "allowable," represented the total number of barrels which pipelines and purchasing companies, canvassed for the purpose, had indicated a willingness to purchase from the various pools of the state at existing market prices during the specified period. After the allowable for the state and the various pools had been determined, the Railroad Commission of Texas conducted open hearings in which expert testimony was introduced for the purpose of proving that if production were not cut to the proposed figure, physical waste would ensue. The Commission then issued proration orders allocating an allowable output to the various pools of the state. Where testimony regarding the amount of oil which might be produced without waste in a particular pool was contradictory in character, the Commission was the final arbiter as to the amount which might be allowed. After the Commission's orders had been issued, this determined allowable for particular pools was prorated to the various producing units upon some agreed basis—by an umpire hired and paid for by the operators and a local, voluntary, supervisory committee created for the purpose. Such, in brief, was the proration machinery as it had developed in the state of Texas by the

close of 1930. Since that date, although in response to court attack and additional powers bestowed by legislation upon the Railroad Commission the machinery has been modified somewhat and its administration taken over by the Railroad Commission, its basic characteristics and major aim—the control of output—remain little changed. Similar machinery directed towards a similar end had been created in the other major oil-producing states by the end of 1930.[7]

As an instrument for the adjustment of oil production to the demands of consumers of oil and its products, the machinery had its defects. Unfortunately, this land has been rather continuously cursed by a surplus of refining capacity.[8] This surplus has become increasingly embarrassing during the last decade. In 1930 the output of all refineries in the United States represented only 74 per cent of the rated daily capacity of all plants operating at the end of the year, and this despite an all-time record in the domestic consumption of gasoline and an all-time record of gasoline in storage. Refineries, anxious to cut down an unwarranted burden of overhead, were willing to purchase crude oil in excess of market requirements for refined gasoline. This was particularly true of refineries located in the vicinity of flush-production fields, for they could apparently show a satisfactory profit by operating at full capacity on low-priced crude even though forced to undersell the market with their low-priced gasoline. An increasing supply of so-called "bootleg gasoline" appearing on the market in recent years is a reflection of this situation.[9] But bootleggers were not the only offenders. Refineries in general through their willingness to buy sufficient crude to operate as nearly as possible at full capacity have been producing gasoline in excess of market requirements during this period of surplus oil output. In recent years the wholesale and retail market situation for gasoline has customarily presented a picture of instability and frequently of demoralization. State-wide proration of crude oil based on market outlet for the

[7] By this time similar proration machinery had been established in Kansas, Oklahoma and California, producing with Texas in the aggregate approximately 85 per cent of the total domestic output. The above description of the Texas proration machinery and the manner in which it worked is based upon mimeographed material secured from the technical adviser of the Central Proration Committee and upon personal observation through attendance at numerous open hearings conducted by the Texas Railroad Commission. For a description of the proration machinery set up in Oklahoma, see "Brief for Appellant Champlin Refining Company in the Supreme Court of the United States," October term, 1931, Docket No. 485, *Champlin Refining Company* v. *Corporation Commission of the State of Oklahoma*, pp. 10-13.

[8] For a discussion of overexpansion in the refining branch of the oil industry, see Edward C. Petty, *Developments in the Petroleum Refining Industry as Related to Overproduction of Crude Oil* (University of Oklahoma, 1931).

[9] The term "bootleg gasoline" as here used refers to gasoline which finds its way to the market through other than the well-established channels by marketers who refuse to follow the lead of the large organizations in matters of price. The term is also used in other connections to refer to gasoline on which payment of the state gasoline tax is evaded.

crude product proved inadequate as a stabilization measure. Its defects challenged the ingenuity of the leaders of the industry. They were not found lacking. Two steps were necessary. First, determination of total domestic demand for refined gasoline and of the supply of crude oil necessary to yield this determined amount under current refining methods, and, second, co-ordination of action among the several major oil-producing states in their proration endeavors. The former was achieved through the establishment of a Voluntary Committee on Petroleum Economics by the Federal Oil Conservation Board and of a similar committee by the American Petroleum Institute. These committees, acting separately, have issued reports at regular intervals, analyzing the market situation for oil and gasoline, estimating the probable demand for gasoline, and indicating the amount of crude oil necessary to meet these requirements. The Voluntary Committee of the Federal Oil Conservation Board has gone so far in past reports as to indicate the proper allocation among the major producing states of the total oil to be produced. Meanwhile, the proration machinery was extended so that it might more adequately fulfill its function in the light of the more complete information it possessed regarding probable oil requirements. The activities of the major producing states were co-ordinated through the instrumentality of an Oil States Advisory Committee set up in the spring of 1931 and representing ten of the major producing states. Since April, 1931, this committee has periodically forecast demand, recommended state quotas of production, and "effectively co-ordinated efforts towards national stabilization."[10] Moreover, if the hopes of the industry and of the Federal Oil Conservation Board are realized, the work of co-ordination of the proration activities of the several states will be permanently provided for by the setting up of an interstate compact to be authorized by Congress under power granted by Article 1, Section 10, Clause 3, of the Federal Constitution. An organized movement for the enactment of such a measure is now under way. Under such a compact, in the language of the Federal Oil Conservation Board, the oil-producing states will be "authorized to collectively exercise their police power in trust for the Nation."[11]

By such means an industry long buffeted by the violent and changing winds of competition has been guided by state aid into the protective haven of monopoly. The sailing has not always been easy, it is true. Confronted by an unexpected spout of oil from the flush production of the newly discovered East Texas and Oklahoma City pools, oil pro-

[10] See Federal Oil Conservation Board, *op. cit.*, p. 19.

[11] Federal Oil Conservation Board, *op. cit.*, pp. 22-23. Interstate compacts of the general sort upon which the proposed Oil States Compact is to be patterned have hitherto been authorized by Congress, involving in the aggregate forty-four different states.

ration agencies, acting as pilots to a storm-tossed and distressed industry, have at times found shipwreck imminent. It has been avoided, however, by assistance promptly rendered by the governors of Oklahoma and Texas in calling out the state militia and forcing a temporary though complete shutdown in both fields. Nor has martial law alone been adequate. On two occasions when court injunctions had temporarily tied the hands of the State Railroad Commission, an emergency session of the Legislature of Texas was called for the purpose of enacting legislation broadening the oil-regulating powers of the State Railroad Commission.

Because the oil industry is not wholly an American enterprise, two other steps have been deemed essential to make the proration machinery really effective. Through the efforts of the independent producers, who have alleged that the proration endeavors of the industry have been nullified through increasing importations of crude oil and refined products, a tariff on crude and its major products was included in the recent "Bill-which-Balanced-the-Budget."[12] Through the efforts of the leaders of the companies operating on a world-wide basis, the general principle of "stabilization . . . by reciprocal engagements to respect relative positions as regards exportations" was agreed upon at the international oil producers' conference in Paris this summer and a somewhat flexible quota plan was adopted designed to insure uniformity of action with regard to price changes and to adapt world production to changing conditions of demand.[13]

As the industry has pursued with unceasing vigor the goal of control of output, it has simultaneously endeavored to standardize its domestic marketing practices by means of a marketing code drawn up by the industry and approved by the Federal Trade Commission. The code, comprehensive in character, condemns as unsound and uneconomic the practices of lending or leasing gasoline pumps, subleasing sites for service stations at reduced rentals, granting credit for installation of equip-

[12] The bill provides for an import duty of one-half cent per gallon on imported crude, two and one-half cents per gallon on imported gasoline, and four cents per gallon on imported lubricants. Since the bill also provides for an internal excise tax of one cent per gallon on gasoline, the net protection to gasoline is one and one-half cents. The tariff on lubricants is designed to compensate for a domestic excise tax of a corresponding amount. It seems unlikely that these duties are high enough to shut out all imports, and there is little doubt that the movement for adequate protection will be carried further. Since we are a net exporter of crude and refined products, the tariff of itself will have little effect on domestic oil prices. It will, no doubt, contribute considerably to the decline in American exports, since low-cost foreign crude and gasoline formerly competing effectively with the higher-cost American product in the Atlantic Coast area will tend to replace the American product abroad. In 1925 American exports of gasoline represented 72 per cent of the total foreign trade in gasoline; in 1931 they represented only 38.6 per cent. This trend will undoubtedly be accelerated by our new tariff policy. On the other hand, the tariff does contribute to the effectiveness of domestic proration.

[13] See *Oil and Gas Journal,* July 28, 1932, p. 11.

ment, selling gasoline from tank-wagons to trucks or other motor vehicles, and deviating from the posted price of gasoline by means of secret rebates, allowances, bonuses, concessions, unusual credits, scrip books or any other plan, device, or scheme which may directly or indirectly permit the buyer to obtain gasoline or kerosene at a net price lower than the posted price. Whatever may have been the aim of such standardization of marketing practices, the motives that prompted it, or the blessings that flow therefrom, it obviously represents an interference with price-affecting activities and it makes more certain the maintenance of a uniform price policy by the oil companies subscribing thereto. It weakens the effectiveness of competitive forces in determining the price of gasoline. Together with proration it translates control of output into control of price. It makes possible the attainment of the business goal of stabilization.[14]

To what extent has this goal been realized? Average daily domestic output has been reduced from 2,950,000 barrels to 2,100,000 barrels within a period of three years. More important, average daily production has been reduced below average daily consumption with the result that total stocks have been reduced by about 11 per cent. Mid-Continent crude oil prices at the end of the first half of 1932 were over twice the levels of a year previous and five times the low of 1931. The f.o.b. Gulf terminal price of 65 octane gasoline has increased from slightly over three cents per gallon to slightly less than six cents within a period of about a year, and a downward trend in retail gasoline prices has been sharply reversed.[15] What other major industry can boast a similar

[14] The code was approved in the late summer of 1929. The machinery for its application to the industry includes a national committee, six regional committees, and subcommittees for states and districts with membership running into the hundreds. See *Oil and Gas Journal,* August 15, 1929. By December 12, 1929, it was announced that over five thousand signatures had been secured to the code and that the bulk of gasoline was being sold under code agreements. See *Oil and Gas Journal,* December 12, 1929, p. 41. Early in 1931 it was announced that the Federal Trade Commission had withdrawn its approval of the code. Upon application of the American Petroleum Institute, reapproval was extended pending hearings. On June 12, 1931, the code with slight modifications was reapproved by the Commission. The code is now under fire in the state of Texas, ouster proceedings having been begun against the major companies subscribing to it.

[15] Joseph E. Pogue, a leading professional petroleum economist and engineer, contends and endeavors to prove statistically that proration has been ineffective as a price control measure. (See "Economics of the Crude Oil Potential in the United States," *International Petroleum Technology,* March, 1931, pp. 24-27). Pogue establishes the fact that during the period of price decline from 1920 to 1926 there was a close correlation between price movements and changes in oil inventory. Since 1926 this correlation has not existed. With but little change in stocks, expressed in day's supply, the price trend has been sharply downward. Pogue explains this discrepancy in terms of the building up of large potentials; i.e., oil held artificially underground through the application of a proration program. Pogue regards this potential as an underground inventory with the same sort of influence on price that above-ground inventories exert. In the more common language of the economist, it represents supply hanging over the market. By regarding this potential as accumulated stocks, Pogue's analysis indicates a continued correlation between price movements and storage in

record? Third-quarter earnings of the oil companies show commendable progress. Although some oil companies have passed their dividends, most remain on a dividend basis. Some continue to pay the regular dividends of the era of prosperity. Some are even declaring extra dividends. On the

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the period from 1926 to 1930. He concludes, therefore, that a proration program which permits the building up of underground potential must be a failure as a price control measure. Despite its appearance of statistical precision, Pogue's analysis is not altogether convincing. Nor is it essential to an adequate explanation of actual price behavior. During the period from 1926 to 1931, when proration was still in an experimental stage and new fields of importance were being developed, proration was an ineffective measure of price control because of the instability and uncertainty of the program. Despite proration throughout most of this period, daily oil production was on the increase until the close of 1929 and stocks continued to mount although less rapidly than in the previous period. At any time during the later period it seemed likely that proration would break down completely. Had it done so, potential production would have become actual inventories. Potential output in this sense and during this period in reality represented supply hanging over the market. Before the close of 1931, however, it became evident that proration, despite the threat of the East Texas and Oklahoma fields, was to be made to work. When that fact was established, the price trend was sharply reversed. So much for the facts.

The chief shortcoming of Pogue's analysis is that he assumes competition in the production and sale of crude oil. A proration program based on so-called market outlet obviously represents monopoly rather than competitive control, and in this instance monoply control with the power of the state behind it. So long as you have such arbitrary restriction of the amount of crude oil which is permitted to flow on to the market, price will inevitably be affected. Any monopolist may have a tremendous reserve of capacity and raw material; but so long as this reserve is not permitted to become supply, it will have no influence on price movements, except to the extent that the breakdown of the monopoly is anticipated. An excellent analogy is afforded by the German potash industry. For more than a quarter of a century under a cartel control, output and price were effectively regulated under a quota system. During all this period capacity to produce potash through the sinking of new mines and the extension of old was tremendously increased. In 1909, when the cartel agreement temporarily broke down and it seemed that potash "potential" would be converted into a supply of potash, prices dropped almost 50 per cent. When the cartel agreement was re-established through state intervention and output was once more effectively restricted, prices promptly rebounded despite the continued existence of a large "potential."

It is possible, of course, that economic pressure might be transmitted into political pressure for the abandonment of proration. The discovery of new fields with increase in "potential" might serve to increase the severity of such pressure. If proration were to break down in the face of such circumstances, "potential" would obviously exert a very serious influence upon price. Likewise, so long as the rate of production of crude oil is effectively curtailed, even in the face of increased capacity to produce, such curtailment must have and, in truth, has had a very considerable influence upon price.

It may be objected by some, who will grant the validity of the foregoing criticism of Pogue's analysis, that proration is nevertheless self-destructive as a price control measure; that it will break down in the same way and for the same reasons that other artificial price control measures have collapsed. It may do so, as suggested in the last paragraph of the foregoing analysis. There are, however, some outstanding differences between this venture in price control and others which have failed. British rubber restrictions, for example, defeated themselves because they contributed very greatly towards an expansion in the plantation rubber industry. But oil is not a plantation industry. Higher prices may result in greater efforts to find oil, but not necessarily in greater findings of oil. Of course, a more intensive search for oil may result in the development of new capacity to produce oil. Meanwhile, however, existing capacity will have been reduced through the natural exhaustion of present fields. Should new discoveries increase total capacity, whether or not this would contribute towards the breakdown of proration would depend in considerable part upon where the new discoveries are located and by whom controlled. Obviously, great oil discoveries in areas

whole, their record would seem to afford a basis for the Federal Oil Conservation Board's claim that the oil industry is the first major industry to emerge from the depression.

Of course, these developments have involved a higher price for a product which a motorized age has made a necessity of life. They have also involved collusive action on an interstate basis among oil producers and state conservation agencies. Nevertheless, they are acclaimed as an achievement of the first rank in the field of industrial control. What a few years ago would have been viewed as a criminal violation of existing anti-trust statutes, federal and state, is now regarded as an act of economic statesmanship. What is the meaning of it all?

If we may believe the leaders of the industry, output restriction, price advance, and profit increase, although good in themselves, have been the incidental consequences of a broader and more public-spirited program. They are the by-products of a program of conservation and waste elimination. The oil men have reversed the dictum of Adam Smith. By consciously endeavoring to promote the public welfare, they have furthered their own selfish interests. So we have been told through press and public forum. Let us, then, examine briefly the achievement of proration as a conservation measure. It is true, as pointed out at an earlier point in this discussion, that uncontrolled production may mean the premature drowning of pools by the rapid infiltration of underground water; it may mean the wasteful dissipation of gas pressure essential for maximum recovery. It does not follow, however, that the application of an arbitrary program of proration which limits total output to "market demand" and distributes it among the various pools and wells on a basis of their potential means conservation. The results are, in truth, more likely to be to the contrary.[16] Where conservation—that is, in-

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not now subjected to proration, would endanger the whole program. Therein lies a distinct weakness of the present plan. Thus far California's proration is largely voluntary in character. Failure to develop a plan of the State Compact sort which will include all producing states, will obviously contribute towards the instability of the whole program. (It should be pointed out that the domestic program may be made to operate independent of the foreign situation behind a tariff wall with restriction of output to the domestic market.) It must be admitted, however, that the whole proration machinery as now established is in delicate balance, the equilibrium of which might at any moment be disturbed. For example, the withdrawal of Texas militia from East Texas under Supreme Court decision on December 12, 1932, threatened the disruption of the entire program. It was avoided by a complete shutdown of the entire field on December 17 for a period of two weeks. This instability of the proration program has been reflected in a weakening in the price of crude oil and of gasoline.

[16] In pools where the major expulsive agent is gas, given a scientific spacing of wells, maximum recovery is more likely to be obtained with an unrestricted flow. This is true by reason of the fact that gas, which is either dissolved in oil or is in a free state above the oil, upon release of pressure tends to slip through the pores more readily than the oil. Curtailment of flow is therefore apt to be more effective in retarding oil output than gas output. The oil is more likely to remain behind. This is a matter subject to determination by experimentation with gas-oil ratios.

In those rarer instances where water drive is the expulsive factor, the situation is

creased ultimate production—is obtained, it is largely a fortuitous feature of the program. In the language of the lower federal court in *MacMillan* v. *Texas Railroad Commission*, conservation must be regarded as only an "accidental incident" to such a program of proration.[17]

Although such incidental consequences may not have been infrequent, the major wastes of the oil industry continue but little abated. Controlled rate of production has contributed in some instances, no doubt, towards a more efficient utilization of water pressure and has increased the ultimate production of particular fields; but because the basis of operation remains the property tract instead of the geological unit—the oil pool—gains in this direction have been but slight and widespread waste continues. Thus on October 31, 1930, the latest date for which data are available, out of a total daily production of 2,045,828,000 cubic feet of gas incidental to oil production in Texas, 467,753,000 cubic feet of raw gas were directly wasted into the atmosphere and 595,562,000 cubic feet were wasted after the gasoline content had been extracted. Total figures for other states are not available, but the Oklahoma Corporation Commission estimates that the Oklahoma City field alone is wasting about 203,000,000 cubic feet of residue gas daily. The fuel equivalent of this daily wastage of gas expressed in terms of coal is approximately 53,000 tons. More important is the fact that under a genuine conservation program with a unified system of production virtually all of this gas could be used for repressuring purposes with a tremendous although indeterminable increase in ultimate recovery. As daily output in East Texas has been restricted from approximately

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likely to be reversed. The water, being heavier than the oil, is found beneath it. Under hydrostatic pressure the water drives the oil before it. But water, too, slips through the voids of the rock more readily than oil. In its enthusiastic endeavor to escape along the line of least resistance, it is apt to "bypath" and leave behind the more sluggish oil. Curtailment in rate of flow retards this tendency. It should be emphasized, however, that in cases of water drive not all wells should be treated alike to keep this tendency to a minimum. A proration program which sets up an arbitrary basis for per-well allowable is at best but a quasi-conservation measure. And of equal importance with rate of flow as a step towards conservation is scientific well spacing, a matter which proration ignores entirely.

It should be observed that the foregoing discussion of proration as a conservation measure is quite inadequate. Lack of space necessitates that it be so. It should be added, also, that by reason of court interference and a desire to protect more adequately correlative property rights, the basis of proration has changed from time to time and from pool to pool. The drift has been away from a reliance on a flat per-well allowable or a per-well allowable on a basis of potential to the utilization of more scientific formulas in determining per-well allowable, as for example, acreage, bottom-hole pressure, sand thickness, gas-oil ratios, etc. On the whole this drift is in the direction of conservation. The principle of conservation, however, has been so continuously and so effectively compromised for the protection of vested rights and the maintenance of the price of oil that waste in the industry continues to bulk large.

[17] *Alfred MacMillan et al v. The Railroad Commission of Texas et al.* In the district Court of the United States for the Western District of Texas. Austin Division No. 390 Equity.

confused situation in the oil industry by contributing to a further ex-

a million barrels per day to 325,000 barrels, the number of producing wells has increased from 1,625 to over 9,000[18] with an increase in developmental cost well over a hundred million dollars. The most striking comment that can be made with any degree of accuracy about such a program as a conservation measure is that it has increased tremendously the cost of producing oil in this field. Verily, as a conservationist, the industry has been straining at a gnat while swallowing a caravan of lusty camels. Behind a smokescreen of conservation it has effectively carried through a program of price fixing. In the language of the District Court of the United States for the Eastern District: "Under the thinly veiled pretense of going about to prevent physical waste the Commission has, in co-operation with persons interested in raising and maintaining prices of oil and its refined products, set on foot a plan which, seated in a desire to bring supply within the compass of demand, derives its impulse and spring from and finds its scope and its extent in the attempt to control the delicate adjustment of market supply and demand, in order to bring and keep oil prices up."[19]

But as the economic depression has deepened, the claims for proration have broadened. It is defended not only as a conservation measure but as a means of lifting the oil industry from depression and thereby contributing towards general economic recovery. The oil industry has not merely pointed the way out of our economic morass; it is said to be leading the procession. Nowhere have I seen a detailed analysis of the manner in which prosperity in oil is to be communicated to industry at large. At best the statement represents an uncritical assertion by those who hope it may be true. Suggestions have been made, however, as to the manner in which these results are to be achieved. In the language of the Federal Oil Conservation Board, "The effects of the industry's rising purchasing power are beginning to be felt. They will be further manifested during the fall and winter if production can be kept on a stable basis."[20]

Let us subject this statement to closer scrutiny. This increased purchasing power in the hands of a particular group has been made possible primarily by higher prices for gasoline. It has been at the expense of approximately 26,000,000 users of automobiles in America. It has been contributed in small bits by practically the entire American population. It represents a transfer of purchasing power from the man of little means and its concentration in the hands of the man of large means. To the extent that it remains in the treasuries of the large corporations undistributed as dividends, it may serve to complicate further an already

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[18] 9,072 as of December 2, 1932.
[19] *MacMillan et al* v. *The Railroad Commission of Texas, op. cit.*
[20] *Federal Oil Conservation Board, op. cit.*, p. 1.

confused situation in the oil industry by contributing to a further expansion of an industry whose chief ill is overexpansion. To the extent that it is paid out as dividends, it tends to swell the purchasing power of those who have at the expense of those who have not. It thereby serves to retard recovery from a depression one of whose major causes, at any rate, has been oversaving occasioned by a maldistribution of national purchasing power. As a means of general economic recovery, stabilization of the oil industry is likely to prove a delusion and a snare.

Despite this fact, we seem to have launched irretrievably upon a program of control for the oil industry. Not only has this program the support of the industry under whose leadership it has been established, but as previously stated, it has been given legal status by legislative enactments. In a number of states its administration has been taken over by state conservation agencies. The influence of our national government has likewise been placed behind it. More important still, it has had the stamp of legality placed upon it by a recent decision of the Supreme Court of the United States. In *Champlin Refining Company* v. *Corporation Commission of the State of Oklahoma et al*, a case involving indirectly the legality of the whole Oklahoma proration scheme, the Supreme Court in a unanimous decision handed down on May 16, 1932, held that the orders of the Corporation Commission were not issued for the "purpose of fixing the price of crude oil nor have they had that effect,"[21] that on the contrary they represent an appropriate exercise of the Commission's power to prevent waste in the production of oil for the protection of the correlative property rights of the owners of a common underground pool of oil.

Space will not permit a complete analysis of the reasoning by which the Supreme Court came to this striking decision. It should be pointed out, however, that the Court was much impressed by the fact that the price trend had been downward throughout virtually the entire period in which proration had been in effect. That fact is in no way in contradiction with the analysis which has been made in the foregoing pages. It has been pointed out that proration was the child of economic distress. It was instituted in the face of expanding petroleum production and declining prices. It was first applied locally. In the face of continuing distress of the same sort as called it into being, the program has been expanded and perfected. By the end of 1930, when its temporary success had permitted an inroad into stocks for the first time, its very foundations were threatened by developments in the Oklahoma and East Texas fields. In the summer of 1931, with the latter field producing a million barrels of oil a day (more than one-third of the total American output) and development only well started, the retreat

[21] *Supreme Court Reporter,* Advance Sheets, June 1, 1932, pp. 539-568.

But despite its economic shortcomings, more than likely the decision

of prices broke into a rout despite the effective functioning of proration in other fields of the country. When it became evident that the heroic steps taken by the governor and legislature of the state of Texas were not to permit production to run wild and wreck the stabilization machinery which had taken years of painstaking effort to erect, prices promptly rebounded. Since the summer of 1931 the trend has been sharply upward. There seems little doubt that artificial restriction of output is responsible for this fact.

More important than the accidents of a price trend in determining the Court's decision, however, is its fallacious assumption that market demand for crude petroleum is a fixed quantity and that production in excess of this amount would inevitably have caused waste. Although the demand for the major petroleum product, gasoline, seems to be relatively inelastic, the demand for crude oil has shown considerable elasticity. In the first place, as its price is lowered, crude cuts more heavily into the fuel market of coal. In truth, this tendency accounts in part for the continued depression from which the coal industry has suffered for the past decade or more. In the second place, as American crude oil becomes lower in price, it cuts temporarily, at any rate, into the market of those foreign crudes whose production, by reason of more concentrated ownership, is more readily subject to control. In the summer of 1931, as the price of East Texas crude dropped to fifteen cents, the market for it broadened with amazing rapidity. The Supreme Court's assumption with regard to a fixed demand for American crude seems to have no logical foundation in either fact or theory.[22]

[22] Professor Fetter takes sharp issue with the above criticism. He points out that the Court refuses to accept the terms "economic waste" and "reasonable market demand" as a basis for its opinion on the grounds that they are too vague and indefinite in character. The Court, holds Professor Fetter, based its opinion on the question as to whether or not the proration orders were designed to eliminate physical waste. Professor Fetter is right only to this extent: The Court held with regard to the penal clauses of the Oklahoma Act that these phrases "are so vague and indefinite that any penalty prescribed for their violation constitutes a denial of due process of law." Having discarded the phrase "reasonable market demand" as too vague and indefinite to serve as a basis for fixing penalty against the violators of the Commission's orders, the Court does not hesitate to use it in its reasoning with regard to the legality of proration. Thus: "The commission construes the act as intended to empower it to limit production to the amount of the *reasonable daily market demand* and to require ratable production by all taking from the common source. In current orders it has found that waste of oil will result in the prorated areas unless production is limited to *such demand*. . . . And it found that the existing stock of crude in storage exceeded the needs of the industry, and that purchasers were unwilling to buy in Oklahoma for storage in any amount sufficient to take the surplus of potential production in that state. . . . The court found . . . that, if no curtailment were applied, crude oil for lack of market demand and adequate storage tanks would inevitably go into earthen storage and be wasted; that the full potential production exceeded all transportation and marketing facilities and market demands; . . . the reasonable market demand [from some pools] was greater in proportion to potential production than in others. . . . In each case the commission has allowed to be produced the full amount of the market demand for each pool. . . . The court found that none of the proration orders here involved were made for the purpose of fixing prices.

REQUISITES OF STABILIZATION IN THE COTTON

But despite its economic shortcomings, more than likely the decision will stand. Other cases are now pending, but whatever may be their outcome, it seems extremely unlikely that the machinery for regulating the production of petroleum will be cast upon the dumpheap. It may be altered; but so long as the industry is threatened with overproduction, it is not likely to be discarded. Nor should it be. If our analysis of the economic and geological character of oil production is sound, unrestricted competition is intolerably destructive. A genuine conservation program demands a type of control which takes as its point of departure the geologic unit—the oil pool. Compulsory unit operation of oil pools would seem to be the next step, a step which many leaders of the industry would indeed welcome. This, of course, would not only permit the exploitation of oil pools without waste, but it would make control over the rate of production even more effective. However, restriction of output, behind the protection of a tariff wall, of an essential raw material upon which the daily lives of almost our entire population have come to depend, invites, if it does not demand, a further extension of control—a type of control under which protection of the consumers' interests will be insured rather than assumed. The oil industry's program of stabilization may point the way towards a more comprehensive and complicated control than the industry had hoped for—or feared.

The fact that the commission never limited production below market demand and the great and long-continued downward trend of prices contemporaneously with the enforcement of proration strongly support the finding that the orders assailed have not had that effect."

In all these uses of the term "market demand" I insist there is the naïve assumption that there is some one amount of oil which can be disposed of at a particular time (without waste) irrespective of price. It is no doubt likely that if all the oil wells of all the flush fields of the United States were simultaneously opened to maximum capacity, daily production would temporarily exceed transportation and storage facilities; but this assumption is quite different from that of the Court—that if production were not restricted to figures set by the Commission (at the request and in the interests of the industry anxious to sustain the price of crude oil and gasoline) production would necessarily result in physical waste of oil. The amount of oil which can and will be taken off the market at five cents per barrel is radically different from the amount which can be disposed of for one dollar. Five-cent oil will quickly find additional transportation and storage facilities, as indeed it has done. With oil in East Texas selling well above this figure, as stated in the discussion above, its market widened promptly. Indeed, it resulted in the carrying of coals to Newcastle. At least three shipments of fifteen-cent crude found their way into Mexico—itself an oil-exporting country. I can only conclude that the Court's decision is based on the naïve and fallacious assumption that market demand for crude oil is a fixed quantity. Let those who doubt this read the decision for themselves.

REQUISITES OF STABILIZATION IN THE COTTON TEXTILE INDUSTRY

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Judged according to the annual consumption of its products, the cotton goods division of the textile industry betrays no great instability. Prior to 1930, cotton goods consumption enjoyed a definite upward trend, and subsequently has declined by less than 20 per cent, despite the relatively more severe decline of public purchasing power.

In sharp contrast to this tenacity of demand is the violent instability of the industry's production behavior. The problem of adjusting output to consumption began to be a serious one as early as 1924 and by 1929 had assumed alarming proportions, independently of the state of general business. Within this period, despite the increasing use of cotton goods, mill shares in New England declined about 80 per cent and in the South approximately one-half.

The see-saw relationship between production and sales is illustrated by the following examples. In 1927, sales in the first quarter ran ahead of production by 30 per cent; in 1928, first quarter sales ran 17 per cent behind production. In the fourth quarter of 1927, sales were 20 per cent under production; in the fourth quarter of 1928, they were 10 per cent ahead of production.

The erratic operation of machinery is vividly portrayed by the accompanying table which shows the extent of fluctuations in spindle hours for selected one-year periods.

Period	*Change in spindle hours* %
March, 1923, to March, 1924	—25
July, 1924, to July, 1925	+35
March, 1927, to March, 1928	—10
April, 1928, to April, 1929	+20
May, 1929, to May, 1930	—26
July, 1930, to July, 1931	+23
July, 1931, to July, 1932	—45

Such behavior implies not only a chronically unwieldly inventory situation, frequent price demoralization and highly fortuitous profits, but also reveals the uneasy position of the workers. Even in relatively good years, mill employees on the average can expect to work only about 75 per cent of full time. This irregularity of employment is a circumstance which is scarcely less adverse to the welfare of the employees than is the lowness of the wage rate.

The underlying downward trend of profits already evident before the general depression of all industries is of course associated with, but

not wholly explained by, the accelerated movement of the industry southward. Although the southern division of the industry had expanded rapidly before 1923, it was supplying the growth needed by the industry as a whole to keep pace with broadening consumption and hence was not depressing in its effect. After 1923 the southern growth did not contribute to the enlargement of the industry as a whole, but was made at the expense of the New England division. Hence, during the remainder of the decade while the South was gaining approximately three million additional spindles with corollary equipment, other states were losing about five and one-half million spindles.

The net shrinkage in physical machinery was more than offset by the growing use of the double-shift in southern cotton mill operations. Strangely enough, this practice reached its crest in the years 1928, 1929, and 1930, after the tendency to chronic overproduction had become evident to the entire trade. It was not uncommon for mills to utilize night-shifts when they were unable to provide more than half-time employment for their day shifts. The industry came into its condition of acute overcapacity in the late twenties, therefore, not primarily because of overinvestment, but because of the frantic efforts to reduce overhead expense by night-work.

Year	*Hours worked per spindle*
1924	2353
1925	2594
1926	2703
1927	2892
1928	2873
1929	3073

From 1924 to 1929 the annual growth of running time per spindle amounted to almost 700 hours which is equivalent to virtually three months running time according to Massachusetts standards. In the one year, from 1928 to 1929, the increase was 200 spindle hours, the equivalent of one full month. But the national average of 3073 hours per spindle in 1929 is dwarfed by the southern average of 3616 hours per spindle for that year.

Although night work reflected intense competitive pressure, it did not stop altogether the making of additional investments. This was due partly to the high degree of specialization in cloth and yarn manufacture. So numerous and so varied are the products of the industry and so kaleidoscopic is the character of demand that the forces of depression do not attack evenly. However unfavorable the general market, there are nearly always certain types of products which are profitable. These scattered and more or less fortuitous opportunities for profits in particular lines are more likely to be met by new plant and equipment than by readjustment of existing establishments.

There is the further fact too of a wide disparity in labor costs between the upper tier of southern states and those that constitute the deep South. A differential of this character is effective only in the manufacture of coarse and medium count staples, but it provides an opportunity for profit regardless of overcapacity elsewhere.

In any case, New England is virtually out of the picture, except in very fine constructions, fancy weaves, and rayon specialties, whose successful manufacture is conditioned less upon cheap labor and automatic looms than upon artistic skill and up-to-the-minute finishing and merchandising facilities. The completeness with which the various fabric classifications have been divided between the two areas suggests that the greater part of the territorial readjustment is over. The major problems with which the industry is now beset, therefore, have but little to do with inter-regional competition.

They are for the most part due to the decentralized and disjointed character of the industry's organization which is unable to cope with the violently fluctuating cotton markets of recent years; has met clumsily the special problems incident to the vastly increased importance of the fashion element in cotton goods; and has established no defenses against the new types of buyers who now dominate the primary cloth markets.

To explain the chaos wrought, it is necessary first to view the industry's structure. In the South, it is still an industry whose units are for the most part relatively small, widely scattered, and numerous. Ownership and management are mostly in the hands of local interests. Very rarely does a single enterprise do more than a fractional part of the processing required to convert raw cotton into a finished usable product. There is instead a series of specialists, the output of one constituting the raw material of the next. Approximately one-fourth are exclusively spinning mills and a small percentage are exclusively weaving mills. Most of the cloth mills do some spinning; a few of them make practically all of their required yarns; and still others produce an excess of yarns, which they dispose of in the market.

A majority of the cloth mills are not equipped to do their own finishing and so sell their products as "grey goods." Finishing, which includes such processes as bleaching, dyeing, printing, and napping, is therefore in the hands of another group of specialists. But between the finishers and the cloth mills is still another group called the converters, who purchase grey goods or semifinished goods from the mills or commission merchants, determine the style characteristics to be imparted, and have the finishers do the actual processing on a price-per-yard basis. In their purchase of grey goods the converters do not for the most part deal directly with the cloth mills but purchase through commission merchants. The latter handle both finished and unfinished goods. Purchasing

a large part of the converter's raw materials for him, they likewise sell for him a goodly portion of his finished goods.

Into the primary cloth markets, where the commission merchants act as chief representatives of most mills, come not only the converters, who are large and shrewd buyers, but also the dry goods wholesalers, the garment manufacturers, the great retail buying organizations, the chain stores, the mail order houses, the buying syndicates, and the large industrial consumers.

These are buyers of vastly greater power than those with whom the mills were wont to deal a decade or more ago. Yet the typical cloth manufacturer not only does not come in touch with them but is satisfied merely to turn over his selling accounts and selling responsibility to a commission merchant, who is at the same time representing from fifteen to seventy-five other mills.

The commission merchant as selling agent is essentially a trader. His major concern is the immediate activity of the market—his volume of sales. Both his income and his standing in the market are conditioned upon moving the goods. He of course dislikes a development which is unfavorable to his mill clients, but as a matter of business he must provide orders for them. His only alternative is to go with the market and become a dynamic part of the daily whirligig.

This alternative is frequently made more urgent by the fact that many mills look to their selling agents for their financing, borrowing from them against orders or on security of goods in stock. As a result of these credit practices, many mills are almost continually in debt to the selling houses. A more vicious method of financing for an overproducing industry could hardly be devised. It has the twofold effect of putting the mills in a position where they must sell goods regardless of cost in order to meet bills payable, and putting the merchants in a position where they must insist upon such action for their own protection.

Beyond the commission merchant in the sequence of processes is the wholesaler or jobber. His importance in textile distribution waned after 1923, but at the present time efforts are being made toward his resuscitation. He differs from the commission merchant in that he buys goods on his own account and sells from stock. His loss of prestige came from the rapid growth of chain stores, from the formation of buying syndicates, and the increasing size of department stores, mail order houses, and garment manufacturers. The larger and stronger buying units tended to brush aside the wholesaler and to approach the commission houses and larger mill organizations directly. This has radically changed the entire aspect of textile goods bargaining. Faced by so formidable an array of buyers who are thoroughly conversant with the weaknesses of the mills and at the same time able to control the placing of large

orders, the commission merchants are in no position to counter effectively. They can only pass back to the mills the price ideas of the buyers and in the present state of the industry the buyers price usually prevails.

An even worse consequence of this inchoate industrial structure is the highly speculative tone that it imparts to all of its intergroup transactions at times when the cotton market is perceptibly fluctuating. A promise of higher prices for cotton produces a stampede of buying all along the line from the yarn market to the final dealer in finished goods. The easy inflow of orders works like a tonic on the mills. They place more contracts for raw cotton. Production schedules are enlarged. Night shifts are thrown into operation. The contagion of forward buying spreads; the increased mill takings give cotton prices another fillip, and the vicious circle is not broken until all inventory space from dealers' shelves to mill warehouse is filled with goods, as in the autumn of 1927 and the spring of 1930. Of course, no thought has been given to consumer behavior; nothing has been happening there.

Precisely the opposite type of reaction attends a downward trend of prices of cotton. Buying becomes stagnant; orders are small and only for immediate needs. The mills perforce must risk manufacturing to stock, or else close down. There is, of course, no basic reason why mill profits and mill volume should be reduced merely because of a decline in cotton prices. It is only the action of the individual mill, pressing for business to counteract the natural desire of dealers, garment manufacturers, and converters to reduce inventories at such a time, that occasions the general price debacle.

Fashion changes play an important rôle in the troubles of the industry. They, too, have been much more pronounced and pervasive in recent years. They have not operated to reduce total consumption but have done their damage by continually forcing changes in the composition of output. The popular fallacy is to associate style changes with apparel goods only. But most fabric constructions are now subject to style changes. Even denims, ginghams, and osnaburgs are susceptible. Overalls, draperies, flour bags, furniture and automobile upholstery, curtain materials, and even sheets and bedspreads have all become extremely sensitive to changing modes.

Before the war probably 80 per cent of textile goods were staple. The other 20 per cent went through its transitions slowly so as not to outpace the slow trickle of fashion through the masses. But these changes are no longer gradual. They now affect virtually every type of fabric in all areas with lightning-like speed. Since the disturbing influences of fashion changes lie in the type and design of goods, the danger to mill converter, or jobber, or garment manufacturer lies in the imminent

possibility that his chosen design or construction may become unpopular—that a sudden change in public taste may leave him with large stocks of unsold and unsalable goods. The seasonal nature of the business accentuates these hazards, as it necessitates manufacture and purchase of goods further in advance than would otherwise be the case, and at the same time increases the danger of a carry-over.

No device has been found that eliminates this risk. The industry annually suffers from this source a loss of many millions of dollars in addition to the millions lost through adverse movements of cotton prices. Each specialist in the industry tries to meet the risk by transferring it to someone else. The retail buyers meet the problem by delaying orders for style goods as long as possible and then clamoring for rush deliveries. The converter does the same thing in his purchases of grey goods, unless the cotton market dictates otherwise, and then at the last minute crowds both mills and the finishers. As the various types of dealers, converters, garment manufacturers, and industrial consumers seek to escape risk in this manner, they add proportionately to the burdens of the mills. Here, the large capital invested and the maintenance of the labor force require regularity of output if operations are to be efficient and profitable, yet attaining it in this way probably means indebtedness, great risk, and overproduction.

When the organization of the industry is thus viewed in its relationship to the cotton market, to the changed character of buyers, and to fashion influences, there is but little wonder that prosperity is the unusual thing, can only be short-lived, and must spring from unusual circumstances. The individual plant as now constituted can do but little as an independent unit to make it otherwise. It is free, to be sure, to increase its own mechanical efficiency in every way possible, but the advantage from this is realizable only to the extent that its competitors fail to do it. Were all existing plants immediately brought to the acme of perfection as regards method and equipment for the manufacturing process, it is doubtful if any one would be the gainer unless radical improvements were effected in the relationship of the various groups that compose the industry.

By the same token, the utilization of cheap and cheaper labor is only of transient advantage to the mills. It merely sets in motion a series of new influences which tend to make all wages lower with only temporary profit to those who have brought it about.

As to the means which will be most effective in stabilizing the industry there are two schools of thought, one insisting upon a radical reorganization of the industry itself and the other upon vigorously directed co-operative action with a retention of the present structure.

That much can be accomplished by the latter method is evidenced by

the work of the Cotton Textile Institute. Organized in 1926, it has through courageous and enlightened leadership steadily grown in its influence upon the industry. In addition to serving as a clearing house of information on current trade data, it has energetically pushed certain reform measures. It has succeeded in gaining from about 82 per cent of the mills a pledge to limit the standard working week for day shifts to 55 hours per week and for night shifts to 50 hours per week. In addition it has striven for the voluntary abandonment of the night employment of women and minors and, in August of this year, had brought 88 per cent of the spindles into compliance with this plan. The greater activity of September and October, however, produced a considerable number of desertions.

In June, 1932, the operations of the industry being at low ebb, the Institute made its boldest stroke to date, recommending to the industry the complete abandonment of night work for one year beginning in October. Before the plan could be ratified, business had begun to pick up "and this, with other factors," to quote from the Institute's report, "demonstrated that the time for such an undertaking was not propitious."

The Institute has been especially active in urging upon the mills the adoption of standard cost systems, in order that they may be more intelligent in their price policies. It now reports that 61 per cent of the mills have reasonably adequate cost methods whereas the percentage in 1925 was only 26. It is not difficult to understand that the application of better cost knowledge has the natural result of encouraging mills to refrain from producing or selling goods at a loss. Whenever this occurs a definite contribution has been made toward bringing about more stabilized conditions.

The Institute has selected as its major objective the avoidance of overproduction. All educational activities and essays in persuasion have this one end in view. It believes that its efforts are at last bearing fruit and as proof of this points with pride to the success of the industry in reducing inventories steadily since 1930. In his annual report for the current year President Sloan points out that the industry's sales for the past two years have exceeded production and that stocks on hand as of September first were 46 per cent less than the three-year average for this date, a truly favorable situation.

It is no disparagement of this fine achievement to state that it was accomplished under the pressure of an almost unbroken three-year decline in the price of raw cotton. Whether overproduction can be avoided under a condition of rising cotton prices still remains to be seen. So far, it has never been done.

There are many who would seek a higher degree of stabilization

through legislative prohibition of night work. However desirable this reform from a social point of view, its chief economic gain would be a diminished rate of speed in bringing about speculative overproduction induced by the cotton market. It would doubtless precipitate a new orgy of mill construction which could probably not be checked until excessive plant capacity once more prevailed. It would in no way touch the major causes of instability which lie in fashion changes, merchandising methods, and raw cotton speculation. There is moreover the almost insurmountable practical difficulty of securing similar legislative action in a sufficient number of states to be effective.

The most hopeful pathway toward greater stability in the industry, though it will be traversed very slowly, is the one which leads to a radical reformation in the industry's structure. The change most needed is a form of control which will supply continuity of supervision all the way from the spinning process to the final disposition of the finished product. In other words, each unit of the industry, instead of being an enterprise with a single function, must be an enterprise which brings together all the processes under a single unified control. As we have noted, the separation of spinner from weaver, of weaver from converter, of converter from commission merchant, of commission merchant from piece-goods buyers and garment manufacturers, has resulted in setting up what is tantamount to a series of speculative mechanisms. Each point of connection plays its part in the clouding of the judgments and activities of the various divisions. Where there should be co-ordination there is conflict; where there should be exclusive interest in the functions necessary to the work of the industry there is often greater interest in the profits from fortuitous circumstances and shrewd forestalling.

With the adoption of unified control, each process is regulated with only one thing in view; and that is the efficient performance of its own particular rôle in providing the finished fabric. It is an arrangement which assumes that the basic controlling influences in the industry emanate from the market for finished goods. It would regard the manufacturing process as being strictly technical in character, concerned only with the scientific aspects of the proper use of raw material, personnel, and machinery. Its proper task is to supply goods according to specifications of those agencies which function in the ultimate markets.

As it is now, production schedules are commonly controlled by men who are not even remotely associated with the market and are wholly ignorant of the forces which are shaping market tendencies. No wonder that so many units are constantly on the verge of insolvency, and that the industry as a whole is continually losing its balance.

With the adoption of large vertical integrations, the way would be opened for the development of what is commonly known as good-will in

the process of distribution—a thing impossible for most of the mills at the present time. The requirements of consumer and trade good-will (that the product be identifiable, that it be produced in volume, that it have publicity and continuity, and that it be not unduly crowded by a multiplicity of competitors) are conditions which can never be met by the many hundreds of textile enterprises which operate as small independent mills. There can be no pride of parenthood. The products of each mill lose their identity and become utterly indistinguishable in the mass of outwardly similar products long before they reach final hands.

Hence in the primary markets the emphasis is always on price. Price weakness developing on any given construction is at once transmitted to the similar products of all mills. No mill has any defense except to withdraw its offerings completely, a policy which it dare not adopt in practice because of its own insignificance in the market. This explains why a recalcitrant or badly managed 10 per cent of the cloth mills can by pushing sales regardless of profit entirely demoralize the market for the remaining 90 per cent.

From the standpoint of textile consumers whether of apparel, piece goods or draperies, the origin of the goods is usually wrapped in deep mystery. A purchaser is usually unable to repeat an order if the goods are satisfactory and equally unable to avoid the products if they are undesirable. It is not a situation which encourages sound policies either in merchandising or manufacturing. Paradoxical indeed it is that an industry which has been successful in the past decade in producing an almost limitless range of fashion goods and novelties in myriads of designs in order that it might humor the vagaries of public taste, at the same time keeps its operations so shrouded that the very consumers to whom it frantically caters know nothing either of the goods or of their makers and are unable to exhibit discrimination even when they desire to.

Though the integration movement is well under way its progress will be necessarily slow. Since the converting and selling agencies are very large units and must continue so, the greatest practical difficulty in the formation of a merger of the vertical type is that there must be either a preliminary horizontal combination of many small mills, or else they must be gradually absorbed by a converting or selling house. The traditional individualism of the small mills is a serious deterrent in either plan. Since textile securities have but little financial standing with bankers or public, combination must be achieved mainly by an exchange of stock, which always involves long drawn out and tedious appraisal operations.

The equivalent of integration has been gained by the rubber tire manufacturers who now own virtually 75 per cent of the tire fabric mills. Marshall Field & Company supplies a large part of its textile

fabrics from its own mills. The Simmons Company has followed a similar policy in meetings its fabric requirements.

Exclusively textile integrations are represented by such organizations as the Cone Mills, the Pepperell Manufacturing Company, the Pacific Mills, the Wamsutta and Nashua Mills, who completed their consolidation within the past few weeks, the United Merchants and Manufacturers Corporation, the Berkshire Fine Spinning Associates, the Holt-Love group of mills, Textiles Incorporated, the Cannon Mills, the Riverside and Dan River Cotton Mills, the Kendall Company and others. The recently reorganized Hunter Commission and Manufacturing Company, which is said to have come to grief primarily because of its banking operations, represents a close tie-up of manufacturing, finishing, and marketing functions.

Throughout the textile field, all important readjustments of organization and structure are definitely in the direction of closer integration of processes all the way from spinning to the final marketing. It is a movement which properly conceives the merchandising function as predominant in control. It aims to minimize commission selling, to transfer financing to the factoring houses and the commercial banks, to reduce the converter from whimsical independence to departmental conformity, to reshape the mills into obedient technical servants. It requires that cotton staple from the standpoint of the mills shall be merely a raw material and not a commodity for speculation; that profits shall come from the creation of utilities and not from shrewd trading among the component parts of the industry; that in the performance of the long sequence of processes from the cotton field to the cloth counter there shall be directness and co-ordination instead of indirection and conflict; that in the analysis of consumer requirements there shall be knowledge and precision instead of guessing and gambling.

DISCUSSION

John D. Clark.—Even those who support the American policy of competition and believe that the wastes of competition are more than counterbalanced by its advantages must concede that petroleum production has characteristics which require a different policy. If no restraint were imposed upon production from the tremendous fields recently developed the limited supply of this irreplaceable natural resource would be shamefully wasted and price would fall so low that the small wells would have to be closed down, never to be reopened.

Three methods of stabilization of oil production may be proposed:

Public ownership, which is no solution for present difficulties because it cannot possibly be attained in time to meet the existing crisis.

The industry might be released from the Sherman Act and agreements restraining production be authorized. But this would require public price-fixing and price-fixing is far more difficult than in the case of any utility. The costs of oil production vary from two cents to two dollars per barrel and our experience with the recapture law affecting railroads has shown that there is no successful way to fix a uniform rate which is compensatory for high cost producers without permitting low cost producers to profit extravagantly.

Ignoring the Sherman Act and the making of agreements for limitation of production. State and federal officials are co-operating in this program and the Department of Justice is quiescent. This program has been reasonably successful in keeping production down and in maintaining prices high enough to keep most producers in business.

I do not agree with Professor Stocking that any burden has been thrown upon the public, for the refinery price of gasoline in Oklahoma, the basic market, is only four cents per gallon.

While this policy of opportunism is extralegal and involves the substitution of the judgment of men for the rules of law, it has many advantages. It permits a reasonable degree of control of production without committing the country to some new policy which might fail disastrously and from which retreat would be impossible. And the Sherman Act and the attorney general are there to protect the public if the policy of stabilization becomes too effective or is continued too long. But they will never have to interfere to restore competition in oil production. As soon as flush production declines and the emergency passes the small producers will overwhelm the advocates of stabilization and the emergency policy will collapse.

Frank A. Fetter.—In this period of depression stabilization is a word for selfishness to conjure with. Many individuals and industries, thinking in terms of their own plight, are declaring that if they were permitted to exact higher prices from the rest of us the general depression would quickly end. This implies a new theory of the business cycle, now and for the future. It is the logic of the panic-stricken in a theater fire. "Let all the rest of you sit calmly in your seats while we clamber over your shoulders and make for the doors." In my brief allotment of time I will confine my remarks to some of the issues raised in Professor Stocking's valuable paper.

The encroachments of special privilege upon popular rights have been steadily advancing in this country. The spirit of monopoly, qualified in various ways, spread from tariffs on manufactures to bounties, land grants, and special corporate franchises, to organized labor, and at length to the hitherto patient and unprivileged small land-owners, farmers, miners, and oil producers. Farm boards, debenture schemes, new and more restrictive tariffs on imports of farm and mine, mob violence to starve neighboring cities into paying higher prices, state executive lawlessness which had at last to be sternly rebuked by the Supreme Court—these have marked the spread of the cancer of monopoly through the body politic and economic of our democracy.

Our inherited English law in respect to the private ownership of subsurface mineral wealth (as of riparian water rights in desert regions) is an astounding anachronism. It originated in a land of different geologic conditions and in an age ignorant of the technological developments of the past century. The discovery of most minerals was until recently the chance reward of unscientific prospecting. The commercial possibilities of petroleum were unsuspected until 250 years after English colonization of North America. Our wealth of public lands continued until forty years ago to be almost given away with the purpose of getting the surface soil swiftly into the hands of "actual settlers." With meagre qualifications it may be said that our federal land policy for a century and a half contemplated the use of land only for agricultural and homestead purposes. All history and experience seemed to justify this aspect of small private property in land, as the magic that transforms deserts into gardens under the hand of the owner-cultivator. It was a policy of national security and public welfare, though fraud often perverted this purpose into a means of plutocratic profit.

When already a large part of the public domain had thus been alienated to private possession, there came in quick succession the discovery of petroleum uses, the development of internal-explosion gas engines, the needs of 25 million automobile owners, and the scientific exploration and exploitation of oil resources. Thus the individual owners of the surface lands were almost entirely released from initiative and enterprise in prospecting for oil and extracting it, just at the time when its value had greatly risen. They received in multitudes of cases enormous incomes without any correlative social service. The worst is not that these oil royalties are pure gifts from the community to private citizens, but that they make the private ownership of surface land in large regions a gigantic game of chance, in comparison with which the Louisiana lottery and other demoralizing gambling proscribed by the moral sentiment of the community and by law, are like playing marbles "for keeps" among schoolboys. Life is exciting when the owner of a quarter section farm worth a few hundred or a few thousand dollars may awake any morning to find himself a millionaire. The gifts of nature to the nation have been made capital lottery prizes for favorites of fortune to be sold back to the nation for many kings' ransoms. Such fruits of private property in land make a jest of the serious arguments in its usual justification. Subterranean mineral treasures should be the regalia of the state for the use and benefit of all the people.

Happily for the nation, the ownership of oil-bearing lands has been diffused among many individuals living in many states, and however much monopoly there has been in refining and marketing oil, there has been, and could be, little monopoly in the price of the crude product. Therefore, as discoveries were more rapidly made, an increasing part of this natural bounty began to be enjoyed by the rest of the people through the medium of lower prices for crude oil. Still, for a time the landowners were blissfully happy; then, a few years ago, as a result of further technical changes, came the shock of lower prices than the oil regions had become accustomed to. Investments had been made and property had been recapitalized upward in all those regions to reflect the high royalties, actual and expected. Then Satan came also, whispering to every investor in all these empires of oil to form a conspiracy for curtailing production in order to raise oil royalties to former levels. To the pure bounty which was theirs by natural scarcity they would add a great further monopolistic gain by illicit "restraint of commerce." Shades of Henry George and the worthy army of land reformers! Monopoly being in violation of existing law, a hue and cry was set up against the Sherman Act, a cry taken up by the great tribe of other monopolists having no direct connection with oil production. The combined political influence of all these interests is stupendous, reaching from nearly every state capitol up to Washington where the full power of presidential influence seems of late to have been put behind the designs of the Federal Oil Conservation Board.

In the scramble for special privilege there is no limit to sophistry and self-deception. The simplest economic terms are misused for the purpose of misleading public opinion. "Stabilization," "economic waste," "conservation of natural resources," "demand and supply," "equalizing cost of production"—whenever the honest citizen hears these terms today it is the signal for "all hands on deck, the republic is in danger." These and related terms are all jumbled together in the laws and the lawless executive proclamations of the oil producing states. The worst confusion in most of the recent discussion of the oil industry has been that between the terms "physical waste" and "economic waste." As Professor Stocking's paper and his previous writings clearly show, the remedy for physical waste is to be found solely in the unitary development of oil pools. Such a change can be effected only by the modification of state land laws, supplemented by special interstate compacts in a few exceptional geologic situations where a pool is crossed by state lines.

The Sherman Anti-Trust statute in no way makes necessary physical waste, though a stupendous propaganda has misled many honest folks into thinking it does. The phrase "economic waste" (and its synonym "production in excess of reasonable market demand") has an utterly different meaning than physical waste. It implies the need and justification of artificial limitation of production to raise or maintain market prices and profits from oil wells. Happily, the recent unanimous decision of the United States Supreme Court in the Oklahoma Oil case, seems pretty clearly to observe this vital distinction. As I read this decision it seems to be one of the most satisfactory expressions of opinion ever given by our highest court in a case involving a large economic issue. I go further in this view than does Professor Stocking, who

qualifies his otherwise favorable comment by declaring that the decision involves the "fallacious assumption that market demand for crude petroleum is a fixed quantity." Such an assumption, if it were made, would, as he says, be without "logical foundation in either fact or theory"; but I can find no phrase in the decision warranting this interpretation. The only phrases in the Oklahoma law or in the Court's opinion that seem capable of carrying such an assumption are "economic waste," and "reasonable market demands," but these terms are repeatedly characterized by the Court as "of uncertain and doubtful meaning," and "so vague and indefinite . . . as to be really no standard at all." Because of the defects in these terms the Court overthrew, as unconstitutional, section nine (providing a penalty) and plainly implied that it would have done the same with section two (with its special emphasis on market demand and "actual value") if the Court had felt called upon to consider that section.

I should like to emphasize even more strongly than does Professor Stocking the contradiction in linking restrictive tariffs on the import of such an exhaustible natural resource as oil with a pretended interest in real national conservation. The obvious effects of such tariffs is the more quickly to exhaust our limited unmined reserves. Free import of crude oil and a substantial excise tax on domestic crude oil production would be the more consistent conservation program.

I would add this brief disclaimer on behalf of those economists who, like myself, still hope to rescue capitalism from the snares of monopoly. They hold no discredited laissez faire philosophy of public policy toward private business. They believe in competition socialized and regulated for the public good. It is not individuals but great associated groups of business men and giant industrial combinations which are now asking to be let alone, which are clamoring for the right to conspire in restraint of commerce, and to control the conditions of production and the prices paid by the people. This is the ominous new philosophy of laissez faire, that has begun to charm some of the impressionable brothers of our economic guild. We are now being told that each organized industrial group should be free to pursue its own monopolistic interest as it sees that interest, and by divine dispensation the result will be in harmony with the best interests of the exploited community. This is the new philosophy of laissez faire.

ROUND TABLE CONFERENCES

AMERICAN ECONOMIC THOUGHT

E. L. Bogart, *Chairman*

The general topic at this session was American Economic Thought and on this subject three papers were read: one by Professor E. A. J. Johnson, of Cornell University, on "Early American Economic Thought"; one by Professor Broadus Mitchell, of Johns Hopkins University, on "The Nationalist School"; and the third by Professor Weston, of the University of Illinois, on "The Ricardian Epoch in American Economics."[1] The discussion was participated in by Professors A. D. H. Kaplan, University of Denver, Leo Rogin, University of California, and J. H. Hollander, Johns Hopkins University.

E. A. J. Johnson.—In sermons, diaries, histories, and colonial laws, there is to be found a fairly complete reproduction of medieval economics teaching. Although Machiavelli had separated politics from theology, and although Bodin had set politics (including economics) apart from moral philosophy, the American Puritans, turning back to the Scriptures and to the teachings of the Primitive Church, refused to accept this separation.

Wealth was regarded as a means whereby man might accomplish his destiny. Recurring to the medieval doctrine of stewardship, the American writers argued that God had appointed each person to fulfill certain functions and for these missions more or less wealth was necessary. Acquisition was sanctioned by divine law since God had endowed the earth with wealth and intended that man should use it. But since wealth was a loan from a gracious deity, this divine loan must be carefully husbanded. Proper use of wealth would produce social peace and happiness and wealth would then be one of the means of achieving salvation. The Christian doctrine of duty gave the key to the use of wealth; temperance, prudence, and charity must guide men in their wealth-using activities.

Inequality had its origin in sin. In the original state of innocency, men had all in common. But avarice ruined this blissful communism which was only practicable in a society of ideal men. Yet avarice, which had destroyed God's intended communism, was not wholly to be condemned. Reiterating a Christian version of Aristotle's objections to communism, the American writers pointed out that private ownership quickened industry, minimized contention, and maximized economic well-being. Moreover, with inequality of possession, there was correlated inequality of social responsibility. Each was a steward and each must perform his duty.

But the individual could not be trusted to perform his duty faithfully. For this reason, government must exert constant surveillance to insure that no one imperilled the economic stratification which arose from the doctrine of stewardship. The consumption of wealth was, therefore, the chief concern of early economic theory. Wealth-getting was not idealized; it was relegated

[1] To be published in the March, 1933, issue of the *American Economic Review.*

to a utilitarian position and subordinated to spiritual activities in the general scale of values.

But the body of medieval thought which is to be found in the writings of both New England and Southern writers in the seventeenth century did not stand alone. Into it was worked a large number of secularized ideas of the sixteenth and seventeenth centuries. In some cases, a fairly reliable doctrinal geneology can be traced. We know, for example, that William Bradford of Plymouth Plantation possessed a copy of Bodin's *Republic.* Bradford's own experience with common ownership at Plymouth gave him great faith in Bodin's work for in it was contained a reiteration of Aristotle's objection to communism.

Of the sixteenth and early seventeenth century writers who, in addition to Bodin, influenced early American economic thought, Thomas More, Calvin, Molinæus, Grotius, and Hobbes, seem to have been the most important. The persistent belief that a colony could provide a place of refuge from economic distress was a popular idea in Europe ever since More had drawn his imperishable picture of Utopia. In the colonial literature, as in the writings of More, the argument is made that less wealth is necessary in a new colony because wants will be simplified and because all will be employed.

Like his medieval predecessors, Cotton Mather attempted an interpretation of Luke VI: 35 to guide him in his attitude toward usury. But unlike his predecessors, Mather came to opposite conclusions contending, as Salmasius, Molinæus, Calvin, and the English critics of Thomas Wilson had done, that the Scriptures did not forbid the taking of interest but only such usury as violated Christian charity.

The influence of Grotius is no less evident than that of More, Bodin, or the critics of the medieval prohibition of usury. Whereas the English mercantilists of the first half of the seventeenth century repudiated Grotius and especially his doctrine of *mare librum,* the early American writers rested their whole case for taking up land in America on reasoning which was either drawn from Grotius or was, in any case, similar.

These illustrations indicate how contemporaneous ideas were worked into a body of reactionary medieval thought. But in the continual modification of economic thought, these borrowed ideas seem to have had less influence than the American environment. The regulation of wealth-getting and wealth-using in terms of a medieval arrangement of economic classes was from the beginning impossible to administer. The rise of wages caused by a scarcity of labor, soon made meaningless a resuscitated medieval doctrine of "fair wages." Efforts to make profits a measure of the extent of improvement which the business man had accomplished went the way of all flesh. The secularizing influence of the frontier was more important than the secularizing influence of European philosophy.

Since the American colonies were offshoots of the commercial ambitions of England and Holland, colonial thought could not escape the influence of contemporary mercantilist thought. But whereas trade was sometimes eulogized as the "blood and life of a commonwealth," the American writers were apathetic at the best and frequently hostile to European mercantilist am-

bitions. This colonial indifference or hostility to European commercial policy did not, however, mean that American economic thought was not influenced by contemporary mercantilist ideas. Borrowing not only the general theory of commercial regulation but also the details, the early American colonists attempted meticulous control of colonial trade. Gradually the elements of a colonial variety of mercantilism is to be discerned.

The eighteenth century brought still another stream of ideas which was to be mingled with the curious medieval-mercantilist blend of the seventeenth. Benjamin Franklin's contacts with Quesnay, Turgot, Mirabeau, and Du Pont de Nemours led him to accept physiocracy and led him to recast his whole system of economic thought. Such an economic philosophy fell upon willing ears for in a country which was primarily agricultural, the thesis that land was the source of wealth seemed self-evident.

Thus in the colonial era, medieval survivals, selected mercantilist ideas, and a borrowed physiocracy were modified and combined. These streams of thought were like gases in a retort while the American environment provided the laboratory conditions under which they were intermingled. Each disappeared as a separate element; all were retained in the admixture. If we are to understand the striking differences between American and European economic thought in the nineteenth century, we cannot disregard the colonial background. The ethical ideas concerning economic conduct, the modified mercantilism, the borrowed physiocracy; all these elements may seem small and insignificant. But if we re-appraise the nineteenth century, institutionally and intellectually, these factors re-emerge with new significance.

Broadus Mitchell.—Of this group, embracing Hamilton, the Careys, Raymond, List, Cardozo, Ware, Niles, Phillips, E. P. Smith, Rae, it may be said that they form a school of thought, which was distinctive, creative, and influential. In spite of important differences between individuals, there was a remarkable unity of doctrine on the whole. Their influence, in development of theory and the application of principles, is readily traced both in this country and abroad; their practical proposals took form in protective tariffs and internal improvements both in America and on the Continent of Europe.

They were original in stressing the relativity of economic principles. The evident potentialities of young America prompted dissent from the preoccupation of the English Classicists with diminishing returns, and suggested that the nation, as an economic entity, thrust itself between the individual and the world of individuals, demanding that it be brought to maturity by the deliberate measures of government.

The American nationalists followed an inductive method. They were in large part men of affairs, reflective and alert to their insistent and changing environment, rather than scholars trained to any philosophy. They did develop, of course, a theory, but this had its origin in expediency. In their thinking, a priori concepts were notably lacking. The extent to which events were their teachers appears in the shifting character of their advocacies as years passed.

It is hardly too much to say that in the minds of the classicists the economic cards were stacked against mankind. Nature was grudging in yielding from her limited stores, and man's contrivance must occupy itself with making insufficient goods go as far as possible. The American nationalists, on the other hand, found themselves on a new continent, where nature was generous and free land was superabundant. Moreover, they were children of the industrial revolution, and had the greatest confidence in the blessings of science and invention. If diminishing returns ever did threaten to set in, human ingenuity would easily be equal to the task of postponing indefinitely the day of lowered living standards. Europeans understood the division of labor, but the Americans, seeing a small population presented with enormous opportunities, went further and developed the theory of the association of labor. Theirs was not the task of acquisition, but of preparation. They were not so much interested in goods as in economic power. Present needs were easily provided for; an enlarged capacity for production and enjoyment was the objective which beckoned them.

Concerned less with private wealth than with public resources, the nationalists considered themselves the advisers of statesmen. They were political economists in the true sense of the term. All government in America, but more specifically the federal government, was in a formative stage, and its powers needed to be enlarged and confirmed as against the powers of the several states. The nationalists' principles of association and centralized direction were threatened by the constitutional scruples of individualists of the republican or democratic school. Furthermore, these writers lived in a country which, economically and politically, had rebelled against authority, and they were of a mind to make rather than to follow tradition and authority. Many of them, moreover, were on familiar terms with legislators and administrators, and several of them occupied official or semiofficial positions.

Some of the conspicuous doctrines and advocacies of the nationalists, after the Civil War, were perverted to private advantage, and, thus bolstered, have taken on a dogmatism which the original defenders would not approve. It may be suggested that the protective tariff is a case in point. If these writers were alive today, they might be found on the side of liberal trade principles and international co-operation, on the ground that we have been brought to economic maturity and that ultimate benefit and not instant advantage should be the object of national policy.

A. D. H. Kaplan.—A greater part of the nineteenth century literature in American economic thought seems to have been devoted to the protective tariff than to any other single topic. This is not surprising when one recognizes how intimately the problem of economic self-sufficiency was associated with the task of nation-building. The emphasis in the early tariff arguments was upon a set of conditions in sharp contrast to those in which our protective tariff is operative today. Thus, from Hamilton to Henry Carey, prominence is given to the thesis that the rise of protected American industry would stimulate the importation of needed men and capital, while an artisan population within the country would bring the consumer market for American produce to our own shores. A new country like the United States, agreed

the tariff theorists, must meet the terms of purchase and sale that were made in the great central markets of Europe. Hence, the transplanting of a portion of the market to our own country would save the then determining item of transportation, to the producer as seller and to the consumer as buyer. Moreover, there is the all-pervading purpose, in the tariff discussion down to the Civil War, of shaping our economic policy so as to bind the loose federation of states into a union of mutually interdependent sections.

Professor Mitchell's remarks serve to draw attention to a noteworthy feature of early tariff discussion; namely, its treatment in terms of the total national good rather than in respect to the special interests of a single class. A recurrent theme is that of bringing "the anvil and the loom by the side of the spade and the plow." On this theme, at least, southerners like DeBow and Gregg make common cause with opponents like the Careys and "Pig Iron" Kelley. The opposition of the American national school to classical British economics was accompanied by a realization that economic policies are not equally applicable to all stages of economic development. Even the most ardent advocates of economic nationalism and protectionism in our early literature intimated that when the national economy had attained a more advanced and more stabilized economic character a less aggressively defensive economic program might properly ensue. In these respects the early literature on economic protectionism, dwelling upon the problem of speeding up our economic development, has little in common with the present protectionism of a nation which has deemed it necessary to check immigration and which possesses the largest national surplus of exportable capital.

Leo Rogin.—History, says Professor Johnson, citing Knies, gives us an account. But, of course, an historical context may give rise to as many accounts as there are interests and points of view to give direction to research, make selection from the welter of facts and endow the exposition with a measure of unity. Dr. Johnson's paper represents the genetic approach. He seems to be interested primarily in relating American thought to the environment in which it emerged as well as to its intellectual antecedents. We agree with his emphasis on the former. It is possible that toward the end of his paper he overemphasizes the influence of foreign intellectual antecedents on American economic thought. The pragmatic impulse behind most social theorizing has a way of directing men to the rediscovery of intellectual expedients.

We suspect the inadequacy of characterizing the vigorous deprecation of money chasing by the American writers of the seventeenth century as a revival of medievalism. We suggest that an attempt be made to relate both the foregoing and the condoning of the taking of interest to the idealogy of Protestantism. In that way much light may be thrown on the celebrated controversy between Tawney, Sombart, and Max Weber, among others, on the subject of religion and the rise of capitalism.

Dr. Mitchell's paper appears to me to be a good illustration of Croce's dictum that when history rises above the level of the chronicle it is inevitably the expression of a vital interest in the present. We hazard the opinion that it is Dr. Mitchell's realistic, practical reaction to his economic environ-

ment and his impatience with laissez faire that has guided his choice of subject and, in a considerable measure, influenced his interpretation. We recognize the greater vitality of the members of the "American Nationalist School" as compared with the American exponents of the classical tradition prior to Francis Walker. But we insist that sympathy with the practical program of a group of theorists should not blind us to deplorable lapses of intellectual performance. A conception of natural laws decidedly more naïve than that of the English classical economists and the uncritical use of physical and biological analogies, for instance, hardly qualifies Henry Carey, "in many ways the leader of the [nationalist] school" as a practitioner of the inductive method. To characterize the group as institutionalist is merely to increase the murkiness of the penumbra which surrounds that sufficiently ambiguous category.

J. H. Hollander.—The group of papers to which we have just listened seem to me notable in aggregate as indicating the growth of interest in an area much too long neglected. Professor Johnson's scholarly survey illumines the economic strain in American seventeenth and early eighteenth century thought, heretofore depressingly obscure. As to Professor Mitchell's brilliant paper, I trust that it will not appear in bad taste if I say that he has given us definite hostage of larger things to come. To Professor Weston's review my reaction is primarily to recall the various implications of the adjective "ricardian." Professor Lowenthal has written of "The Ricardian Socialists"; Francis A. Walker referred to himself as a "Ricardian of the Ricardians"; Marshall's synthesis evoked Ashley's gibe "The Rehabilitation of Ricardo"; the most brilliant single piece of work of the lamented Simon N. Patten is to my mind his paper on "The Interpretation of Ricardo"; finally it was to John B. Clark's appreciation that I owe my own interest in the great English economist. In each of these uses "Ricardian" was applied to a different phase of influence. Perhaps the explanation is that a gem of first water has many facets. Beyond these brief words, my only comment is that Professor Weston has inadvertently quoted me only in part. What I have said of Clark is: "In the inveterate quality of his reasoning, in the resistless force of his penetration, in the logical symmetry of his conclusions there is something reminiscent of Ricardo."[1]

[1] "John Bates Clark as an Economist" in *Economic Essays Contributed in Honor of John Bates Clark* (New York, 1927), p. 4. It is interesting to compare Professor Weston's survey throughout with this paper, and with my article on "American School of Political Economy" in *Palgrave's Dictionary of Political Economy* (ed. Higgs; London, 1926).

THE FORMATION OF CAPITAL: MEASUREMENT AND RELATION TO ECONOMIC INSTABILITY

ALVIN H. HANSEN, *Chairman*

The following paper was prepared for this session, although it arrived too late to be presented. Informal discussion brought out many additional points but no record was kept of this discussion.

DAVID FRIDAY.—The line of cleavage which runs between that part of the national income spent for the acquisition of durable things which add to the stock of our national wealth, as against that which is spent for goods and services which are used up currently in maintaining our standard of living, has long been recognized as a most important distinction in our industrial process. Political economy has concerned itself with the problem from the very inception of the science. Yet we have, up to this time, no satisfactory statistical determination of the division of income as between these two categories of capital formation and consumption.

In the earlier history of the science, and especially during the rapidly evolving industrialism of the nineteenth century, it was the scarcity of capital which furnished the setting for the problem. The economist and the public financier were continually preoccupied with ways and means of increasing the supply of capital. Every proposal of social amelioration, every tax law, was scanned with a view to discovering its effect by way of discouraging or in any way lessening capital formation. Few accusations against any legislative project were more potent than this—that it would dry up the investment funds of the nation.

Of late years, and especially during the present world depression, the whole subject has come into great prominence once more. But the emphasis has been shifted. Writers have less to say about the amount of capital accumulation than about the lack of equilibrium between savings and investment. In America we hear continually assertions of overextension of facilities for producing goods. There is hardly a single field of industry which does not give the banker, who is the purveyor of an important part of the community's capital, concern because of the overextended state of its equipment. Even agriculture, which has for this country at least succeeded in answering that century-old prayer, *Da nobis panem nostrum,* finds that while the prayer is still repeated every morning, it is continually accused of having brought its troubles upon its own head by overexpansion. Every raw material producing industry is being assailed for the same reason. The like is true of manufactures, transportation, housing, and the construction industry generally. Economists and financial statisticians are continually spying upon industrial process with a view to detecting an undue rate of activity in the production of durable capital goods and in the accumulation of inventories. Even the investment of our capital abroad is criticised bitterly for its volume.

We have come to realize, finally, that the maintenance of balance between production and demand, and the stabilization of employment, cannot be accomplished unless the process of capital formation can be freed from

those wide variations which it now manifests. For it is in this branch of our productive activity that the widest swings occur. Before we can go much further in solving this problem of economic stability which besets us so sorely, we must have more precise information about the volume, composition, and fluctuation of capital formation.

Any act which alters the stream of production as a whole in favor of durable goods as against short-lived goods and services is an act of capital formation. The fundamental nature of the process of capital formation is, therefore, not to be found in the accumulation or storing up of stocks of goods or in the hoarding of money. It is to be found rather in a decision to direct the productive forces of industrial society to one type of creative activity rather than another. It follows from this definition that the accumulation of capital in a given industrial society during any period consists of all the goods which have been produced and not yet consumed. The accumulation of capital in any nation throughout its existence is represented by its whole stock of wealth and goods which have been acquired by its industry. If one is not dealing with a closed and isolated industrial order, but with a modern nation which has normal international financial relations, its capital formation during any given year will consist of:

(1) Durable goods produced within the year which, because of their very nature, would not or could not be consumed within the year.

(2) Increases in the inventories of consumable goods must be added to the volume of more durable goods brought forth; and decreases in such inventories must be subtracted.

(3) The sum of (1) and (2) above must be increased by the net amount of capital invested abroad, or decreased by borrowings from foreign nations.

This definition of capital will offend those who still think of capital as "the products of past industry used as aids to further production." This was practically Adam Smith's definition. He even excluded houses and the like from the category because "they are still as really a stock reserved for immediate consumption as either clothes or furniture." This limitation of capital to productive equipment passed with the clarification of the concept which resulted from the controversy over the nature and necessity of interest. Once it became evident that interest was paid for the distinctive service of waiting, it was only a matter of time until it was realized that the producion of any good which called for waiting contributed to the demand for capital. Since all goods whose use, either in production or consumption, required time, called for waiting on the part of some one, they contributed to the demand for capital. In short, they were capital goods, and their production was an act of capital formation.

Much time has been spent, in the history of our science, on the definition of capital; and it is not proposed to waste more here. It is clear that any statistical investigation of the process of capital formation today must be based upon a concept sufficiently broad to meet the requirements of the problem of business depression and industrial stabilization. All durable goods and all accumulation of inventories have several points of similarity. They all

involve waiting in their production and use. They all make it possible, because of their durability, to suspend production of these particular goods for some time without greatly curtailing the use and enjoyment to be derived from them. Suspend the production of food for a year and the population will starve. But the people will not go unsheltered even if no new houses are built for several years; and we would have a reasonably abundant supply of automotive transportation even though the industry were completely closed down for a twelve-month. Nearly all sorts of durable goods have become a basis for credit and investment. Here little distinction is made between the productive and the consumptive categories. As a matter of fact, the largest single source of demand for waiting is probably found in the consumption category of housing. Nothing short of a review of the entire process of production for durable goods is adequate to meet the needs of the student of business cycles and industrial stabilization. We need to know how large the flow of such products is, how it fluctuates, through what channels of trade it flows to its ultimate owner. And we need to know their value as measured by their cost to the final owner. Exact information concerning this part of the industrial process is indispensable if we are to stabilize the stream of production and employment.

At present we do not know the volume of these goods produced, nor the amount of the money income of the nation which is absorbed in paying for them. We do know that the variations in the volume of their output are much greater than those of the less durable goods which flow immediately into consumption. Thus, between the peak month of 1929 and the summer of 1932, the output of those durable goods which are included in the Federal Reserve Board index of industrial production fell 75 per cent in volume, while the other commodities declined only 30 per cent. Clearly, there is no possibility of stabilizing industry unless these fluctuations can be reduced. At the peak, the absolute volume of these two classes of products included in the Reserve Board's index was the same. At the bottom the durable goods amounted to only 40 per cent of the other class. The suspicion besets us that our credit structure has too often operated to accentuate these wide swings rather than to curb them. However, we now have no exact knowledge of these durable goods which are produced and financed annually, in terms of their value to the person or corporation who ultimately buys and owns them.

Several theoretical questions are inevitably presented in the planning of such an investigation. These deserve discussion here. One of them pertains to the line of demarcation between durable goods and consumption goods. How durable must things be to warrant their inclusion in the category of capital and to be included in the stream of capital formation? Railroads and other transportation systems, electric light and power plants, factories and their equipment, streets and highways, houses, commercial and public buildings, orchards, tile drains, fences—all these clearly belong in the category of capital. Automobiles must likewise be included. But what about furniture, including carpets and rugs; what of books? These things are highly durable. Certainly the electric refrigerator would be included; and if all of these

things be added in shall we include clothes as well, and bed and table linen?

Many of us would probably be inclined to balk at the inclusion of house furnishings and personal clothing. But there can be little doubt that they affect in an important degree the demand for durable goods, and so the process of capital formation. At the present moment there is stagnation in the furniture trade just because furniture is durable; and a large amount of it was produced and sold during the recent period of prosperity. The same thing is true of custom tailoring for men; and of carpets and rugs and of many other lines of house furnishings. It is probable that at the end of a period of moderate recession such as we suffered in 1924, and in the early stages of the succeeding revival, the amount of money capital available in the investment markets of the country was increased by the fact that durable goods accumulated in the hands of consumers were not yet worn out. This enabled the public to make savings for investment, for bank deposits, or for payment of debt, which could not have been made had it not been for these accumulated inventories which remained from the previous period of prosperity.

Germany affords a practical example during the years 1924-25. There the small volume of these durable goods produced and purchased for several years previous led to a great exhaustion of *Hausvorräte*. When revival came in 1925, the scarcity of investment funds continued for many months, largely because the Germans invested their first savings in stocks of these goods. These products constitute one of the most important causes of modification in the income stream; and this factor of variation grows more potent as the standard of living for the great mass of people rises. It should be included in the category of capital goods.

Another problem of theory has had practically no consideration from American scholars. It is the treatment of depreciation. A large part of the durable goods currently produced is said to be for replacement of other units of capital which have been discarded because of wear and tear or obsolescence. Is the entire stream of durable goods which results from production to be considered as capital formation; or must a deduction be made for that part which represents depreciation? The importance of the question, quantitatively considered, becomes apparent when we realize that corporations deducted about four billion dollars for depreciation in 1929. This item had been included in operating expenses as a deduction from gross profits in arriving at net income. The surplus of these concerns after dividends was $2,320,000,000. No one doubts that this surplus item constituted savings and was available for the purchase of durable goods. But the sum set aside for depreciation was also available for this purpose. And it was almost twice as large as the surplus. All told, these corporations had over six billion dollars available for such purposes from their operation. Which of these figures shall be included as representing the capital formation of the country through corporate savings?

From the standpoint of strict logical analysis, the amount charged for depreciation and depletion represents an act of savings quite as much as does the retention of surplus. Capital is maintained, not by preservation,

but by reproduction; and every decision to produce a new unit of durable goods is an act of volition which modifies the income stream in favor of capital formation and to the ensmallment of production for consumption. Depreciation charges, while they are an operating expense, differ from other expenses in one important respect. They represent no current disbursement, as do the expenditures for labor and materials which are currently consumed. A sum equal to these depreciation charges is therefore available for new plant and equipment, either by way of replacement or for plant extension. If a power plant, or a machine in a factory, or a locomotive on a railroad is abandoned on account of obsolescence, it is not replaced by one of the old type, but by a new unit which represents the latest and most efficient development in the art. The capital, measured in money terms, remains in the balance sheet at the old figure, but the physical plant which embodies it has taken on a new and more efficient form.

Considered from this point of view, the depreciation allowance performs one of the most vital functions of savings, because it is available in its entirety for the utilization and installation of new technical developments. Such new developments have always been recognized as one of the most important sources of the demand for waiting; and the emphasis upon an abundant supply of savings derived from the fact that the new capital thus created made possible the enjoyment of the benefits of technical advancement. Even if no new savings were made out of private income for investment in our industrial establishments, these could still embody a large part of the newly acquired technical knowledge through the utilization of these funds which represent their provision.

This whole question of the economic role played by depreciation, especially when it is due to obsolescence, is a subject which has had little attention from economic theorists. There is no doubt that obsolescence is an important source of demand for new capital. In any investigation directed at measuring that demand, its role in the process of capital formation should be made the subject of study.

It should be noted, too, that the volume of capital formation in no wise depends upon the wisdom or unwisdom of its investment. It has been argued repeatedly in America that the productive facilities bought and paid for out of corporate surplus cannot be counted as capital accumulation in their entirety, for the reason that they are often unwisely invested and therefore wasted. Doubtless it is desirable to know what proportion of our annual savings is wasted through unwise investment. But these funds cannot be wasted until they have first been saved; and the waste does not occur until the savings have resulted in the formation of actual capital goods which are proven by subsequent experience to be worthless. To deny that there was capital formation simply because that capital is unwisely used merely beclouds the issues involved.

One of the reasons for agitating this subject of the statistical measurement of capital formation at this time is found in the nature of the material which has been made available in recent years, and especially by the Census of 1929. The necessary data for this inquiry, as outlined above,

have never been available for the United States until now. Indeed, it is not now available for any other country in the world. Our own census of manufactures has contained a good deal of information on the physical volume of goods produced and the value of this industrial product. Since 1919 manufacturing data have been collected and reported every second year; so that the material is fairly continuous. It covers three boom years and two years of serious or violent depression, as well as one of mild recession. The years 1919, 1923, and 1929 all enjoyed a high degree of activity in the manufacturing industry. In 1921 we suffered from a serious depression, and in 1927 a mild recession occurred. The Census of 1931 should be available within the next six months and will picture the situation in one of the major depressions of modern history. These data, covering a dozen years, must be the foundation upon which any determination of the volume of capital formation shall be built.

But for most of this period there were two difficulties in the use of these data for the construction of a picture calculated to show the flow of these goods and the amount of the national money income which they absorbed. The first shortcoming was that the census of manufactures did not distinguish between products used as materials in further manufacture (commonly called "semimanufactures") and those which were sold to the ultimate user. Many of these manufactures were durable goods; e.g., electric motors used in automobiles or electric refrigerators. To include both them and the ultimate products of which they became a part would lead to obvious duplication; yet nowhere were the items sold to other industrial users and included in other products shown separately.

This defect has been remedied in large measure by the Census of 1929. This includes a study which shows the purchase of domestic semimanufactures by other manufacturing establishments. It also shows the distribution of sales by manufacturing plants, and it reveals the sales of manufactures to industrial consumers. By analyzing this material it is possible to eliminate the duplication and arrive at the net volume of production for these durable manufactured products.

The other difficulty in using the material available previous to 1929 for the purposes here outlined is that their value was given at the factory door and not at the point where title passed to the ultimate owner for whose use they were destined. For several reasons it is the latter figure and not the former that is important. The part of the national income which is absorbed by these goods is represented by the final price which is paid for them, and not by the valuation placed upon them at the factory door. The purchase of such goods is often financed by bank credit or by the issue of securities in exchange for savings. It is the ultimate price of houses, automobiles, furniture, or railroad equipment which determines the amount of financing which will be needed. We have never known this ultimate price before, nor the relation of prices in the retail market to wholesale prices, nor the relation of either of these to the value at the factory. In the field of construction work, we have never known the ratio of the value of finished projects to the cost of the materials which

went into them. The only figure available was the price of materials at the factory door.

Heretofore we have had only indices which showed the relative volume of these durable goods produced from year to year. A summation of the value of these products to their final users was never possible. This difficulty has been obviated by the data which is presented in the census of distribution for wholesale trade and for retail trade; and by the census of construction. All three of these were taken for the first time in 1929. The publications of these new divisions of the census make it possible to ascertain the value of each class of durable goods as measured by the price which its ultimate purchaser pays for it. It will also show the relation of that price to the value at the factory door.

These durable goods should be classified into producers' goods and durable consumers' goods. Such a classification will enable anyone who objects to the inclusion of some category or other to eliminate that group from the total.

This material is available only for the year 1929. There is no telling when another census of distribution and of construction will be taken. But it should be possible to make some intelligent approximation of the value of all durable goods for each of the census years back to 1919 with the aid of the data derived from a careful study of 1929. And it should likewise be possible to carry it forward in 1931 and subsequent census years. One of the most interesting results which should be derived from these figures is the illumination which they will afford for the operations of our credit machinery. Every type of these goods gives rise to financial operations running all the way from long-term bonds to installment sales. These are all evidences of indebtedness which are purchased by the banks and which absorb the savings of the people. When once our financial community knows what it is financing, it may be able to formulate a banking and credit policy which shall help to maintain stability.

Ultimately the work here outlined should lead to the construction and maintenance of a monthly and also an annual index number for the production of durable goods. This should be compiled currently and published probably by some governmental agency such as the Federal Reserve Board or the Department of Commerce.

SIZE OF BUSINESS UNIT AS A FACTOR IN EFFICIENCY OF MARKETING

H. B. PRICE, *Chairman*

The general topic of this session is size of the business unit as a factor in the efficiency of marketing. The economies of size of the business unit although fairly well established for manufacturing industries are not so discernable in marketing. The organization for selling introduces problems of efficiency that are different from those of physical supply, and apparently costs of selling respond to the influence of size somewhat differently than the costs of handling and storing products. Price realization also relates to size of the business unit in a distinctive manner. Research in marketing has thus far neither differentiated these various aspects of marketing clearly nor pointed out distinctly the relation of each aspect to size and cost of operation; nor has as much attention been given to the factors affecting the efficiency of marketing as of manufacturing or agricultural production. A considerable body of material bearing on the problem is now available from the various public and private marketing research agencies. The object of this round table is to present some of these materials from representative fields in marketing research.

PAUL L. MILLER.—Any advantage that a relatively large-scale marketing business has over a relatively small-scale one must come from one or both of two factors. Either its unit costs must be lower, or the prices that it is able to secure for the product must be higher, or perhaps it has advantage from both of these factors. With respect to operating costs, we must grant that volume of business is very influential. The principles of large-scale production apply to marketing operations as well as to those of manufacturing.[1] In so far as the utilization of equipment and plant is concerned the cases are quite the same. Many marketing businesses have mechanical and routine operations that can be organized and performed most efficiently in a relatively large-scale unit. It is true perhaps that buying and selling operations cannot be as minutely specialized and reduced to simple routines as many other types of tasks. But in the case of many farm products that may be sold in quantity to large-scale buyers on definite specifications, selling is much less personal and more amenable to organization than in the case of many other products. It would seem to be largely a matter of training and experience together with administrative ability. If so, large-scale enterprises have a great advantage in their ability to command the highest type of service.

The price advantages afforded by volume of business are no less real if somewhat more elusive than the cost advantages. They obtain in the broad markets of farm products and particularly in the case of those commodities that are sufficiently standardized to be sold on the basis of description. In such markets sellers best able to make the commodity available in quantity and in accordance with precise quality specifications are able to secure the superior outlets. Ability to supply the commodity on such terms, other conditions remaining the same, is within limits a function of volume.

[1] Clark and Weld, *Marketing Agricultural Products,* p. 470.

The price advantages enjoyed by such suppliers must be sharply distinguished from those that may in some instances be forced from the market through some degree of monopoly control. The former price advantages result from a more economical meeting of the demand than is possible on the part of small-scale suppliers, who usually cannot cater to the same class of trade but must depend upon intermediaries for their outlets. The latter price advantage, where it can be realized, is obviously purely exploitive and predatory.

It is in the country end of agricultural marketing where marketing business units appear to be particularly undersized. In the wholesaling of farm products business units are for the most part large-scale enterprises and, generally speaking, margins are narrow and costs are low. But, in the country this is not the case. The exceptions to this are in those commodities and in those districts where farmers have co-operated to market on a larger scale and more efficient basis. Outstanding examples of such developments are the large-scale, co-operative marketing enterprises of the citrus fruit growers of California and of the poultry and egg producers of California, Washington, and Oregon. Other examples might be cited. Nearly every commodity furnishes many instances of significant steps taken by farmers to improve farm marketing. Generally speaking, progress has been greatest in highly specialized producing regions, remote from the principal market centers, and in the case of commodities that go to consumers without processing.

In the case of grain and livestock, as well as of other commodities produced widely in a general or mixed type of farming, country marketing generally is on a small and inefficient scale. Most of the farmers' co-operatives are loosely formed, and indifferently supported. For the most part they lead a precarious existence competing with local buyers. The majority of the farmers sell to local buyers, many of whom are small, independent operators. Others are representatives of packers, milling firms, or wholesale marketing agencies. These large buying agencies often buy at many shipping points scattered over a wide territory. As rural transportation and communication have improved, such buyers have extended their country buying systems and taken a larger and larger place in buying directly from farmers. They have had little trouble in either driving out the local independent buyers or making them their representatives.

This might seem to indicate that they have been able to place country buying on a much more efficient basis, and they doubtless are more efficient than the independent dealers;[2] yet the extent to which they can increase the efficiency of country marketing is distinctly limited. The reasons for this are first, that they cannot greatly reduce the expense of buying and handling the commodity at the point of contact with farmers. Farmers are naturally pleased to have as many bids to consider as possible. This seems very advantageous to them, and in a sense it is. Yet it makes farm buying very expensive because of duplication of effort. In numerous grain shipping localities in Iowa there are three or more grain companies represented with operators and plants where

[2] E. G. Nourse, ***Recent Economic Changes,*** National Bureau of Economic Research, Vol. II, p. 580.

one set of equipment could handle the grain at much lower cost. Cost studies of local marketing agencies reveal wide ranges of costs and close correlations between costs and volume of business.[3] Yet, in the usual local market situation the business is split up among several handlers so that average marketing costs are much higher than they need to be. This seems to be the price that the farmer has to pay for having buyers carry their competition for his products down to the farm.

A second reason why the integration of local buying by central market agencies does not go far towards greater efficiency in the marketing of the products of a particular community is that such buying agencies cannot be said to widen the market for the locality. In fact where the local trade passes into the hands of a relatively few central market interests, the product of the community may be less widely distributed than formerly. Add to this possibility, the fact that the farmer in his individual capacity is far from being an expert salesman, and there can be little doubt that these developments in large-scale country buying weaken rather than strengthen his trading position.

These cursory observations of the inefficiency of local marketing point to small-scale farm selling as its chief cause. The buyers, large, and small, in the country trade cannot be held responsible for the wasteful methods of marketing evident in most localities. They are, generally speaking, not the cause of these conditions, but rather the effects. Farmers' co-operative agencies, organized in a manner that forces them to compete with local buyers, have been able scarcely to hold their own, and have not increased the efficiency of marketing. The roots of the problem lie too deep to be eradicated by reform methods that only aim to substitute one type of middleman for another. For improvement in conditions the farmers need to combine so as to reorganize farm marketing on a large-scale basis.

Much of the co-operative movement among farmers has missed the main opportunities to increase the efficiency of agricultural marketing, which lie in the handling of the commodity at the farm and at local points and in the development of efficient sales units to administer the selling of the product of a district. The farmers of a given locality need to combine on a sufficient scale to enable them to substitute large-scale for small-scale methods in the trade of the locality. Much of co-operative marketing fails to bring together the farmers of a given locality or district in sufficient numbers for most efficient local handling of the commodity. The result is that much of co-operative marketing among farmers has failed to increase the efficiency of marketing in the country trade. These weaknesses of local and regional co-operatives cannot be remedied by combining such enterprises into central or even national units. Such agencies cannot remedy inadequate co-operation among the farmers themselves.

Nathanael H. Engle.—In attempting to measure statistically the influence of size upon the operating efficiency of a wholesale establishment one of the first problems is the selection of a unit of size. Practically this is not a serious problem since there is little choice. Theoretically, there are a number of alternative criteria of size which should be considered.

[3] Clark and Weld, *Marketing Agricultural Products,* Chapter XXI.

One of the more definite of these is a unit of physical volume such as a ton of merchandise. Another method is the use of the individual sales transaction. Other methods of measuring the size of a merchandising establishment are the number of square feet of floor space, the number of employees, or the volume of sales. The last of these is the one which I have selected by a sort of Hobson's choice to measure the effect of size upon the operating efficiency of wholesale merchants dealing in manufactured goods. For most purposes the sales dollar is as good a measure as any of the others. Certainly for purposes of comparison between different establishments operating in the same year it offers a definite and easily understood size unit.

TABLE 1

TOTAL EXPENSES[c] AS PER CENT OF NET SALES FOR WHOLESALE MERCHANTS IN SELECTED TRADES, BY SIZE OF BUSINESS, UNITED STATES, 1929[a]

Size Groups (net sales in thousands of dollars)	Kind of Business (Trade)							
	Drug (general line)	Dry Goods (specialty)	Electrical Goods	Groceries	Hardware (general line)	Hardware (specialty)	Paints and Varnishes	Radio Sets
Total	13.3	10.3	16.1	9.8	18.5	19.5	21.8	15.9
Under 50	17.8	13.5	21.6	13.8	24.3	27.3	28.2	26.7
50 to 100	14.8	12.8	20.1	8.9	21.5	21.9	24.0	21.1
100 to 200	16.1	10.0	18.9	9.0	20.4	22.9	22.5	20.3
200 to 300	13.7	10.3	17.9	9.6	19.0	20.2	23.8	20.7
300 to 400	12.9	9.4	17.9	8.9	20.1	19.7	22.9	16.3
400 to 500	14.2	*9.0*	17.0	*8.7*	20.4	19.4	20.5	18.4
500 to 1,000	13.6	9.7	16.7	9.5	18.7	21.6	22.0	16.2
1,000 to 2,000	13.3	10.0	15.2	9.7	18.1	18.1	19.3	*14.1*
2,000 to 4,000	13.1	9.8	14.5	9.6	17.9	13.6	*18.0*	—
4,000 to 8,000	*12.8*	11.6	*12.5*	11.8	17.3	*12.3*	—	—
8,000 to 15,000	13.4	12.1	—	14.8	*16.7*	—	—	—
15,000 to 25,000	—	—	—	—	20.8	—	—	—

After the size unit has been selected, a second problem is the determination of the best measure of operating efficiency. If by operating efficiency we mean the degree of economy with which the economic factors of production are used in performing the marketing functions, it is reasonable to assume that the money costs incurred in performing these functions roughly measure the degree of marketing efficiency. I have acted upon this assumption and have used the operating expense ratios compiled by the Census Bureau.

I have based this study entirely upon statistics which I have helped to compile while with the Bureau of the Census. The facts have been assembled and summarized from a special series of trade studies for eight groups of wholesale merchants, each of which carried a different line of manufactured goods. For the most part these establishments constitute a homogeneous group of merchants operating in much the same way and performing most of the wholesaling functions. In addition, I have made a special study from the schedules of 2,418 general line wholesale merchants in the grocery trade in which I attempt to measure the effect of size upon a number of specific marketing functions as well as the combined total of such functions.

A few conclusions may be drawn from the statistics shown in Table 1 which covers the total expenses for eight trades. Without exception, the very small-scale establishments in all the trades reported relatively high operating expenses. Aside from this one similarity, the different trades were affected variously by size of business. In four trades, electrical goods, hardware specialties, paints and varnishes, and radio sets, the total expenses expressed as percentages of net sales declined with minor variations as the size of the business increased. A large scale of operations is not always best, however. In two trades, dry goods and groceries, total expenses declined from 13.5 per cent and 13.8 per cent of net sales to 9.0 per cent and 8.7 per cent respectively as size of business increased to $400,000-$500,000. As the size of business increased thereafter expenses increased to 12.1 per cent and 14.8 per

TABLE 2

NUMBER OF ESTABLISHMENTS AND NET SALES BY SIZE OF BUSINESS, WHOLESALE MERCHANTS—GENERAL LINE GROCERS, UNITED STATES, 1929[a]

Size Groups (net sales in thousands of dollars)		Number of Establishments	Net Sales	Per Cent of Total Net Sales
Total		2,418	$1,708,437,660	100.00
I	100 to 500	1,335	376,274,075	22.02
II	500 to 1,000	671	471,712,411	27.61
III	1,000 to 3,000	351	548,896,540	32.14
IV	3,000 to 8,000	55	242,400,418	14.18
V	8,000 to 25,000	6	69,154,216	4.05

TABLE 3

EFFECT OF SIZE ON EXPENSE AND OPERATING ITEMS, WHOLESALE MERCHANTS—GENERAL LINE GROCERIES, UNITED STATES, 1929[b]

Size Groups	Per Cent of Net Sales							
	Total Expenses[c]	Total Wages[d]	Direct Selling Expense[e]	Interest Paid[f]	Rent Paid[f]	Credit Sales[f]	Returns and Allowances[f]	Inventories
Total	9.83	5.56	2.57	0.49	0.52	85.99	2.12	14.48
I	9.03	4.72	2.49	0.53	0.68	81.75	1.70	14.01
II	9.48	5.29	2.43	0.49	0.54	86.20	1.87	14.62
III	9.50	5.44	2.39	0.49	0.46	86.15	2.82	14.10
IV	11.08	6.55	2.91	0.46	0.41	91.90	1.70	14.70
V	14.83	9.51	3.98	0.43	0.46	85.31	3.05	18.23

[a] *Census of Wholesale Distribution, Trade Series.* The number of establishments for each group constitutes all of those reporting to the census bureau—practically all in the United States.

[b] *Census of Wholesale Distribution,* special tabulation. No establishments from communities of less than 10,000 people and no establishments with sales below $100,000 per year.

[c] Exclusive of net profits.

[d] Includes salaries of hired employees, but excludes salaries of proprietors and firm members.

[e] Includes salaries, commissions, bonuses, and expenses of salesmen for only those establishments reporting salesmen.

[f] Percentage based upon statistics from only those establishments reporting these items.

cent respectively for the establishments with sales between eight and fifteen million dollars. In the two remaining trades the evidence is less conclusive. However, expenses showed an increase in the largest size group.

Few if any generalizations are indicated by the statistics in Table 1. If it were not for the dry goods specialty wholesalers whose costs increased in the larger brackets, a rule for specialty wholesalers might have been suggested to the effect that costs vary inversely with the size of the business. The more reasonable explanation appears to be that sales had not been pushed far enough by the four specialty groups to incur increased costs. The evidence, therefore, as to the influence of size of business upon wholesale merchants as a group is not conclusive. For a few specific trades, however, such as groceries, it seems clear that large-scale business is not the most efficient.

In order to determine the incidence of size upon specific marketing functions, I prepared a special tabulation for 2,418 grocery wholesalers. (See Tables 2 and 3.) Summarizing the facts brought out in these tables it appears that for wholesale merchants in the grocery business, the total costs of performing the marketing functions vary directly with the size of the business after sales have reached a minimum of $100,000 per year. Expenses incurred for labor also increase as the size of the business increases. Selling efficiency as measured by the costs of performing the selling function decreases as the sales volume becomes larger. On the other hand, efficiency in performing the storage function as measured by rent expenditures varies directly with sales volume and is greatest with sales between $3,000,000 and $8,000,000. In so far as interest payments are a clue to efficiency in performing the function of market finance the large-scale houses seem to have the advantage. The granting of credit, however, which also reflects the finance function, does not indicate any very definite relation to sales volume. The two remaining indexes of marketing efficiency, returns and allowances and inventories, indicate that the very large establishments are least efficient.

In conclusion I believe that the facts brought together in this paper indicate: that a very small scale of operations for wholesalers of manufactured goods is less efficient than a somewhat larger scale, that there is a fairly wide range in which size of business has very little measurable effect upon operating efficiency, that there is a maximum size in some trades and possibly in all beyond which operating efficiency diminishes and, finally, that the incidence of size upon marketing efficiency is not uniform for all of the marketing functions.

W. H. S. Stevens.—In manufacturing industry based upon the Federal Trade Commission's intensive study of plant cost by size of plant in the bread industry for a period of years, we may conclude, first, that though both price (as indicated by sales realization) and cost per unit decline as the size of plant increases, costs decline more rapidly than sales realization and net profit per unit tends to rise. Second, that if the bread results are typical, multiple plant operation does not reduce the cost of producing and selling for plants of the same size.

In the field of retailing as in the field of manufacturing the effect of size may be examined from the standpoint of size of the retail store or since the

growth of large chains, from the standpoint of size measured by units operated.

For the effect of size of establishment, the most comprehensive figures available are those of the Harvard Bureau of Business Research. This organization has compiled as percentages of sales, the gross margins, operating expenses and net profits of several kinds of business for varying periods of from one to ten years or more.

The most comprehensive of these sets of figures is in the department store field where the figures cover the eleven years, 1921-31. The larger stores average substantially higher gross margin, operating expense, and net profit percentages on sales, the higher net profits, of course, arising from the fact that the gross margins of the larger stores are relatively higher as compared with the operating expenses than is true of the smaller sizes of stores. Retail shoe stores show the same tendency as department stores. Excluding the smallest of the grocery size groups, the larger sizes of stores usually show the highest gross margins, as high or higher operating expenses than the smaller stores, and the largest net profit percentages.

All three of these retail lines, it will be observed, differ from manufacturing in showing higher operating expenses for the larger establishments. In jewelry retailing, however, an entirely different tendency appears and the results more closely resemble those in manufacturing. Here, both gross profits and operating expenses tend to decrease with the size of store, the latter figure somewhat more than the former, with a consequent increase in net profit for the larger establishments. Automobile tire and accessory dealers show the same tendencies as jewelry retailers though the figures in this case cover only the year 1923.

Summarizing the results of the Harvard studies, therefore, it appears possible to conclude: that in groceries, department stores, and shoes, the tendency is for gross margin, operating expense, and net profit percentages of sales to increase with increase in the size of store, a greater increase in the margin than in operating expense accounting for the increased net profit; that in jewelry and automobile accessory retailing, gross margins and operating expenses both tend to fall as the size of the establishment increases, the net profit, however, tending to increase because of a lesser decline in the gross margin than in the operating expense; operating expenses do not therefore tend to decline generally in retailing with increases in the size of unit as in manufacturing but in both, net profit tends to vary directly with the size of the particular manufacturing or retailing establishment.

It is by no means certain how far and to what extent variations of operating expenses with the size of establishment are actually dependent upon the size of the store involved. The reason is that there is a considerable volume of data in both the Harvard Bureau and the census figures indicating that operating expenses tend to vary, to some extent, directly with the size of the city, particularly when comparisons involve very large and very small cities and it appears obvious that at least within certain limits the size of store will vary with the size of the city.

The Harvard Bureau of Business Research has tabulated its department

store figures for 1929 in nine size volume groups. In these figures, the variations in the gross and net profits and operating expenses by size of city appear to be appreciably greater than by size of store, thus seeming to lend support to the conclusion that the size of city is of greater importance than the size of store in producing variations in financial results.

Time has been lacking to permit extensive computations from census figures necessary to any generalized statement as to the effect of size of city. I have, however, compared the per cent of operating expense to sales for ten kinds of business in all cities in Pennsylvania of under 10,000 and 10,000 to 30,000 population with those for Allentown (92,000 population), Scranton (143,000), Pittsburgh (669,000), and Philadelphia (practically, 2,000,000). For most of these ten kinds of business, cities of 10,000 to 30,000 population commonly show higher operating expenses (proprietors' salaries being included by the census method of average wage of full-time store employee) than those of under 10,000. The average operating expense percentages for these two smaller sizes of cities in Pennsylvania, moreover, are also usually lower than those for any of the four larger cities mentioned, in each of the ten kinds of business, though exceptions occur particularly in grocery, grocery and meat, and variety. At this point, however, the effect of size of city becomes less apparent. Allentown, though under 100,000, is higher than Philadelphia in six of the ten kinds of business while Scranton is likewise higher for a majority of the groups than either Pittsburgh or Philadelphia. Pittsburgh also shows a higher operating expense ratio than Philadelphia in at least six of the ten kinds of business.

This brings us to a consideration of the difference in the operating results of single and multiple unit (chain) stores. Census figures of the per cent of operating expenses to sales, for both chains and independents, are available for twelve kinds of business. In every one of these types of business, with the exception of grocery, department stores, and women's shoe stores, the chains show a higher ratio of operating expenses to sales. The figures of gross and net profit, of course, are not shown by the census.

Although multiple unit operation in retailing apparently leads to higher ratios of operating expenses to sales, therefore, as compared with unit operation because of differences in functions, this does not necessarily mean that the gross margins or operating expenses involved in getting goods from the producer to the consumer are higher through the multiple unit operations of the chain. Dr. N. C. Engle, formerly of the Wholesale Division of the Census of Distribution, has furnished me with certain computations in which the census independent, wholesale, and retail figures of operating expenses are combined, for five lines, clothing and furnishings, drugs and drug sundries, groceries and food specialties, meat and meat products, and house furnishings. In all these lines except the last named, the combination wholesaler-retailer operating expense percentages exceed those of the chain. Dr. Schmaltz arrived also at the same conclusion for groceries in an article in the *Harvard Business Review* combining the results of the Harvard Bureau's studies of grocery chains with their combined figures for grocery wholesaling and retailing. Offsetting this to some extent, however, is the greater service of

the independents who more generally give credit and delivery to consumers.

One further point in connection with the effect of size in retailing concerns the relation of the number of retail units to operating expenses, gross margins, and net profits. Harvard Bureau figures are available for 1929 for all three of these items in the case of shoe, drug, and grocery chains though for only three size groups. Because of the small number of groups, the results are not entirely satisfactory. There is some indication of a decrease in gross profit with increases in the number of units in shoes and drugs with a better indication of an increase in this item in groceries. Operating expense increases with size in groceries but declines in shoes and drugs while net profit increases in groceries and drugs and, with some qualification, in shoes.

The census figures on this point are for operating expenses only. I have used twelve types of business in this comparison. In only three of these, office appliances, variety, and possibly hardware chains, is there any tendency for operating expenses to increase with the number of stores operated. Drugs and shoes are, in my judgment, indeterminate though the tendency, if there is any, seems to be for the expense to decline with increases in the number of stores. Department stores I would also class as indeterminate. The remaining lines, women's apparel, furniture, auto accessories, grocery, combination grocery and meat, and possibly installment jewelry show a downward trend with increases in stores operated. The figures are open to some question because in drugs and the two grocery groups, warehousing and other overhead is not included for the large chains operating warehouses. This might easily affect the showing for the larger chain groups.

As in the case of unit stores, however, there are certain indications that operating expense variations of chains according to the number of stores operated may be due no more or perhaps even less to the number of stores involved than to their location. Chain operating expenses by size of city are available in the census data for only four kinds of business, grocery, combination grocery and meat, shoes, and drugs. In each case, there is an appreciable increase in operating expense with the size of city which is especially pronounced in shoes and combination grocery and meat.

Drugs present the only case in which the census has to date broken down the figures by size of chain within the size of city and though the figures are only for cities of over 100,000 and under 30,000 population, the rather decided differences between them would tend to confirm the view that size of city is a factor of at least equal importance with the size of establishment.

The fact that the variations of expenses are so great for drug chains of the same size operating in cities of different size combined with the fact that in cities of the same size there are still important variations in expenses for different sizes of these chains points to the conclusion that the effects of either size of store or size of chain upon gross margins, operating expenses, or net profits cannot and will not be thoroughly understood until size volume figures are analyzed according to the population of the cities in which they are operated. The Harvard Bureau must be given credit for recognizing that the size of city was an important factor in operating results and they have in the past presented a number of analyses of this character

along with those by size of establishment. An analysis of their past results for unit stores by size of establishment in cities of varying ranges of population would be extremely valuable. And the same applies to their wholesale figures. Such a composite breakdown is apparently not practicable from the published census figures, though the information necessary for it was obtained. It would seem more than worth while in any subsequent census to publish either such a breakdown or the data for making it.

W. J. Donald.—The merger movement is not over and once financial markets become favorable to security flotations, we may well expect it to return in considerable volume. Meantime, the kinds of mergers that are taking place, for the most part, are the purchase of plant, goodwill, patents, and business of small companies by large companies, and the purchase of the securities of a small company by a large company, often conditional on net profits.

The marketing advantages and economies to be secured from mergers vary widely according to the class of merger or combination of classes of merger. Among those which have been generally assumed are the following: stabilization of price in highly competitive markets, standardization of products in the interests of a lower price and a lower cost of production from large-scale continuous operations, reduction of expense of advertising, reduction of the sales force, reduction of the total number of branch offices and branch office expense, improvement in the quality of marketing staff service available in the marketing of all products in the line, the rounding out of a family of products, reduction of sales administration overhead, reduction of sales traveling expense, reduction of transportation charges through elimination of cross shipments, strengthening of the position of the company in reciprocal selling, strengthening of the position of the merged company in relation to large dealers, especially department stores, chains and syndicates, reduction of the number of drops and the amount of distressed merchandise once the initial stages of the merger are completed, partial elimination of competition from inferior products, advantages of more adequate financing of purchases, especially through an allied installment credit corporation, increased security for trade marks, making possible a stronger policy of selective distribution.

While not all of these marketing advantages of mergers apply to all mergers and while many of the plans that could have been realized have not functioned effectively in many cases, and while the marketing aspect of mergers has been most neglected, nevertheless, it is my opinion that the possibilities are quite as great as have been claimed and that they will yet be realized if sound marketing policies are developed for each individual situation.

SESSION ON FEDERAL RESERVE POLICY SINCE 1926

RESERVE BANK POLICY AND ECONOMIC PLANNING[1]

By HAROLD L. REED
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Of the numerous and varied products of the existing depression, the most significant, from the standpoint of future governmental structure, is the intensification of the demand that this country should immediately create new agencies to be vested with economic planning responsibilities. Despite the fact that it has long been orthodox doctrine to hold that a large degree of community interference is required to permit the competitive system to function equitably, despite the tendency to declare that more and more industries are vested with a public interest, despite the tremendous increase of regulatory boards and commissions in all branches of government, it is becoming increasingly popular to urge that private enterprise should be subjected to still more direction and control. Otherwise, we are informed, the only alternative is Sovietism, and Sovietism must be a dreadful state. For, if it were not, we would not be willing to contemplate so many vexatious devices to avoid it.

Many of the most widely discussed of recent plans to secure the more harmonious utilization of our material resources are confessedly councils of despair in that their proponents do not, at the present stage, profess ability to refute even the most superficial of objections. Despite the wide and varied experience out of which it grew, and the loftiness of purpose of its author, the Swope plan cannot guarantee any means whereby outputs can be properly adjusted to consumption demand unless the trade association is given power to restrict arbitrarily the entrance into the industry of new competing enterprises. As for a goodly portion of the plans to set up national economic councils, the thinking has admittedly not gone far beyond the stage of organization and structure. It is merely hoped that much good might result if provision were made for the formal and regular gathering together of representatives of important economic interests on a council definitely charged with the responsibility of giving advice to legislative and administrative authorities. So far as I am aware, no one has yet advocated that such a

[1] The reader is requested not to assume in advance that the writer's thesis will be that the Reserve banks should take unto themselves such planning responsibilities as have been delegated to national councils in several European countries. The writer intended to argue that by the wise exercise of existing credit powers the Reserve banks could lessen the necessity for such planning bodies. If the writer does not make this position clear he is open to adverse criticism on the ground that the Reserve banks are not so constituted, administratively, as to justify the delegation of detailed economic planning responsibilities to them. If the exposition is consistent with his intention, however, such criticism would be a misinterpretation of his paper.

council should be substituted, with power to enact legislation, for one of the houses of the federal Congress, both of which are now organized on the basis of geographical representation. The present program is to create new agencies of control, not to destroy or systematize old.

In the field of credit, particularly in that of investment banking, there are also pressing demands that we graft on to existing agencies new boards of control or advice. It is advocated in several current proposals that, without the consent of a credit planning commission, new securities could not be issued or distributed; and that licenses to appeal to the country's investors should be granted only after the formulation of a plan, designed to keep the various industries in step and in harmony. The unescapable difficulty that partiality could not be avoided in allotments is held to be a minor evil as compared with the consequences of proceeding further with existing methods of procuring funds from investors.

In estimating the probability that such new agencies would operate successfully it is necessary to inquire whether they would possess advantages over existing planning organizations. I do not believe it special pleading to argue that in the credit field we already have a planning agency with broad and extensive powers. Central banking systems are the products of years of experience and of constant adaptation of their operations to the requirements of particular economic situations. For decades they have been the repositories of a wealth of information proceeding from business contacts and operating experience. They deal in the vital fluid of competitive enterprise credit—and yet they have generally escaped responsibility for making special and particularized decisions. It is true that this observation might be held to be inconsistent with the fact that our Federal Reserve banks are required to accept or deny specific discount applications by member banks. But as a matter of procedure most such decisions are based on rules of thumb; and it is furthermore generally true that the initiative of our Reserve banks in conducting open market operations is a decisive factor in determining whether discount applications will be made by member banks in large or in small volume. At any rate, it is a function of the member banks to distribute credit among rival bidders. Federal Reserve responsibilities relate principally to such general powers as influencing the cost and supply of credit, and not to selecting the particular enterprises among which credit is to be allotted.

Many of the objections applicable to plans to create new agencies for the promotion of economic harmonies cannot therefore be made against the type of planning for which a central banking system seems clearly adapted. It is accordingly essential that more thought be given by economists than has been to the possibilities of securing through

central banking operations some of the objectives of current planning suggestions before traveling the perilous paths toward trade organization control, toward formally recognized national economic councils, toward governmental agencies to ration and allot long-term credit.

If now we argue that the Reserve bank directorial bodies possess certain definite advantages as economic planning agencies, agencies to which much of our stabilization program should be entrusted, it is necessary to inquire as to the help that economists may give them. Unless purposive, economic thinking of a broad character becomes dominant in their councils, the Reserve banks must continue to be regarded as part of the domain of private banking. We must determine, therefore, as precisely as we can how applicable current business cycle theories are to the type of facts with which any central banking system is directly concerned. What prospect is there of reaching some measure of agreement among proponents of rival theories so far as the task is that of finding a basis for practical banking operations? To what extent can the rival doctrines be subjected to statistical verification so that any application of them will seem to be realistic; so that, in other words, men of analysis, on the one hand, and administrators on the other, will find a common meeting ground? What possibility is there that, in the practical problems of credit and banking, economists may be moved to distinguish between attempts to solve the distant ultimates and efforts to uncover proximate realities? What, in short, have economists to offer the type of men who always will occupy positions of influence in central banking administration? Although satisfactory answers to any of these questions cannot here be given, a mite of progress may perhaps be realized.

At the present juncture, there would probably be little disagreement among economists with the assertion that, for our purposes, a large part of business cycle theory cannot be utilized. Without disparaging its value for other purposes, it will be readily admitted, I believe, that much of prevailing theory is the result merely of ingenious exercises in the drawing of deductions from premises, the truth of which may not be universal. To my mind a case in point is the brilliant work of Foster and Catchings—and I go out of my way to say brilliant because so many adverse critics seem not to understand their argument. Their analysis does reveal clearly how, if saving goes beyond certain limits, difficulties must be encountered in finding a market for the outputs of industry. But the initial equations, which are asserted to represent a condition of equilibrium, make no formal entry for saving. It cannot be denied, however, that, without saving, a society possessing the other characteristics therein ascribed, must shortly experience a diminution in outputs. From the very first the doctrine is thus posed

in such a way as merely to raise the question whether saving can go too far. It itself does not reveal the amount of saving necessary to permit equilibrium to be maintained year after year between production and consumption demand. Informative as the doctrine may be with respect to possible processes it cannot be accepted as a basis for a stabilization policy.

Many other doctrines which are frankly intended to be directly applicable to central banking problems reveal a confidence that is amazing with respect to the simplicity with which it is assumed financial forces operate. A variety of such theories assume there is some magical quality in a central bank's discount rate. Frequently, it seems unnecessary for adherents of such doctrines to inquire whether the fundamental fact is the availability of credit, or the cost of obtaining credit. The processes, moreover, by which credit flows from one use to another, the obstructions encountered in its flow, the conditions governing the relationship of central bank operations to member bank activities, the circumstances which influence member banks in utilizing, say, surplus reserves, the factors which in turn govern the borrowing dispositions of the business public, these to many economists seem to be unessential questions. The influence of a high or low bank rate upon business activity is often regarded as direct and universal in the intensity of its influence. A low rate, so it is sometimes alleged, gets translated immediately into higher prices for the "non-available output" by means of the discount process. To others a low interest rate stimulates purchasing even by dealers and traders who have a quick turnover through the process of reducing costs. Such doctrines, no matter how useful they may be for some purposes, demand too much faith in the influence of particular, and perhaps minute, processes to be acceptable to bankers who know something of other powerful forces that are always at work.

Nor can I omit friendly reference at this point to the zeal with which some price stabilizationists have overworked the doctrines of their inspiration by assuming under all conditions the easy responsiveness of commodity prices to money and credit policies. In recent years there has been a tremendous amount of discussion regarding the particular price level to which, by means of credit policies, we should endeavor to return speedily. Would it be better to re-establish the level of 1926, or the average for the 1928-32 period, or some other price level? And should the governing index reflect wholesale prices, costs of living, or a more general array of goods and services including perhaps the prices of intermediate goods? Does not much discussion of this type fail to reckon with the possibility that under certain conditions it may be beyond our power to avoid some instability in our standard of deferred payments, or that temporary success in such stabilization efforts might

finally result in violent and perhaps uncontrollable price movements of a reverse character.

To drive home this point, I should like to make reference to the activities of the Reserve banks in the middle of 1927. Although undoubtedly conceived to accomplish other ends, the greatly increased open market purchase of the Reserve banks in the first half of 1927, and the ensuing reductions in discount schedules from July of that year on, represented precisely the sort of action we should have expected of our central banking system if it had been under mandate to stabilize wholesale price levels. For, during 1926, the Bureau of Labor Statistics wholesale price index declined by about 5 per cent, and, during the early part of 1927, this mild, but steady, downward movement continued. Toward this downward movement a variety of factors undoubtedly contributed. But, in my belief, we should admit the influence of an unusually rapid introduction by manufacturing enterprises, especially, of improved machinery and cost-saving processes of all sorts. This contention may be ill founded. But whether or not it is, disproof cannot, I think, be found in statistics of production of the type which show that the annual rate of growth in total outputs from, say, 1922 to 1928, was not far out of line with pre-war trends. Technical and organization improvements, I believe, had much more often the consequences of reducing costs and of increasing capacities than they did of expanding outputs. Consideration of unemployment tendencies in this period adds support to this interpretation. But even if I can be convicted of error in this assertion, I shall not be greatly worried. Any assumption erroneous as to facts can easily be made the hypothesis of a period which we may experience in the future.

As a result of these Federal Reserve easing measures the growth of member bank loans and investments from the first quarter of 1927 to the middle of 1928 was extremely large, in fact much in excess of the 1922-29 average. Largely as a consequence, I hold, the supply of credit made available to business corporations by means of new non-refunding, security issues was of record volume. Through investment offerings funds were obtained which, when distributed through the normal channels of trade, so sustained the money demands for goods of all types that, until almost the close of 1929, the downward movement of wholesale prices was checked. But this stabilization of prices was accompanied by a remarkable expansion of our capital equipment. Productive power was so geared up that, ever since the 1929 recession in the security markets, it has been difficult to find a satisfactory outlet for bank credit in plant improvement projects.

The rapid price declines of recent years may therefore be characterized, I think, very largely as a belated consequence of the easing

credit measures of 1927. In other words, it may properly be asked if commodity prices which do not sufficiently respond to reduced per unit costs of production may not just as appropriately deserve the opprobrious term of inflation as might, under other conditions, an actually advancing price level. The argument here might possibly be strengthened by calling attention to international factors. To attempt to sustain domestic commodity prices by credit devices when, in other nations, contrary forces are at work, may necessitate the creation of so much credit as to encourage serious abuses in the investment and speculative markets. It may be that this phase of the problem will be dealt with in the following paper.

Since this illustration has been long I may reiterate that I am trying to show the impossibility of utilizing certain stabilization doctrines which assume that the world in which we live is so ordered that we may easily avoid fluctuations in the purchasing power of our monetary unit by means of credit policies if only we have the will to do so. It may perhaps be true that, if we are to avoid extensive price derangements, we must accept minor readjustments in prices, as well as in the volume of business activity, as part of our inexorable destiny.

The above-stated appraisals of the inadaptability for our purposes of much of the business cycle and stabilization doctrine that is current are given merely as a prelude to the kind of theory that here will be offered. Our doctrine must, if possible, be dressed in a terminology that is understandable to banking executives; it must not be crowded with ultimates when proximate realities will suffice; it must not be fashioned to accomplish too grandiose objects; it must, as far as is possible, be capable of statistical verification; it perhaps should be little more than intelligent empiricism. At the same time, however, it should be capable of being interpreted in terms of the processes by means of which economic forces operate.

But what should be the cardinal points in such a doctrine? With especial reference now to economic and financial processes, the following are suggested:

1. There must be full recognition of the proposition which our chairman has so ably expounded[2] that the real starting point of disorderly liquidation is the general rush of those in debt to get out of debt. The moment debtors as a class decide that they have overreached themselves, all sorts of disturbances are initiated which tend to develop with cumulative force. Anxiety to convert assets into cash is the universal proximate cause of disorderly price declines and of liquidation in all its more violent aspects. To check such liquidation, purchasing power in the form of bank credit must in some way be restored. Despite much

[2] Irving Fisher, *Booms and Depressions*.

general opinion to the contrary, I do not believe that business cycle theory has demonstrated successfully how, outside the field of released banking power, depression automatically generates forces capable of overcoming the constantly increasing evils resulting from the general pressure to liquidate debts.

2. The most important underlying cause of a general disposition of entrepreneurs to liquidate is the fact that new debts are not being created in sufficient volume. There is nothing wrong with debts per se because a vital aspect of business is the contracting of debts by some in the hope that such debts can be liquidated out of funds circulated among the members of the business community as a consequence of the borrowings of others. Indebtedness is incurred only because there is confidence that new debts will regularly succeed and take the place of old debts. In other words, since most private debts are paid by drawing checks against banks, the constant and normal flow of bank credit into new business transactions must not be interrupted if old debtors are to be kept from initiating disturbing liquidation.

3. The banking system must be so organized, if the purpose is to avoid periods of disorderly liquidation, that hesitation among the entrepreneural classes will shortly be countered by decisive efforts on the part of banks to get more credit into use. In this respect it may fairly be questioned if the American banking system operates as successfully as in the days prior to the organization of the Federal Reserve system. Member banks have been taught that they should not plan to employ Federal Reserve credit for extended periods of time. But experience shows that in boom years an irregular and intermittent nibbling into the reservoir of reserve credit by a large number of member banks will give rise to a considerable volume of discount indebtedness. After the turn in business arrives, bankers like other business men strive nervously to erase these debts. In the absence of such windfalls as the receipt of gold from abroad and favorable central bank operations, bankers as a class cannot discharge their debts to the reserve institutions save by reducing the volume of their deposit obligations through calling loans. But the rapid calling of loans destroys the worth of bank assets. Vigorous counteraction by the Reserve banks, by means of such processes as extensive open market purchases of government securities, is then required to stem the tide of liquidation. In an acute emergency the mere establishment of low discount rates is likely to be of little avail.

4. If the volume of debts contracted before a severe shock to confidence has been large it is probable that open market operations designed merely to erase member banks' discount indebtedness will not be sufficient to restore the flow of bank credit throughout the business community in sufficient volume to check disorderly liquidation. When

business activity recedes bankers become more conservative in granting credit, and, in a declining securities market, bank deposits, in comparison with holdings of corporate equities, become more preferred by investors. A refusal at such a time of depositors to invest has essentially the same consequences as at other times would result from the removal from business use of a portion of the outstanding exchange medium.

5. In the distribution of bank credit the long-term capital operations of business are of great importance, because these operations constitute that portion of our economic activity which at all times exercises an especially potent influence upon prices. Funds released in plant improvement projects, for instance, tend to produce at once an intensification of the money demands for all types of goods; and, at the same time without the consequence of increasing immediately the flow of consumers' goods to the market. While such capital operations may normally be highly sensitive to money market conditions because they are more adaptable to long-term borrowings, in which money rates are of the most importance, they may be quite irresponsive to even favorable credit conditions in periods of depression. In every serious reaction the more or less universal testimony of entrepreneurs is that plant capacities exceed any requirements immediately in prospect. Explanations of the tendency of business concerns to overbuild plants in times of activity are numerous and varied. Leaving out of account "psychological" tendencies to overestimate future demands, the following "technical" factors deserve especial emphasis for our purposes:

a. The entrepreneur has frequently no real opportunity to decide upon a middle course. Ten extra subscribers may compel a small telephone company to insert a new switchboard section containing a hundred drops. Where an 80 horse power electric motor is required, a 100 horse power motor may have to be installed for the reason that there is no commercial size between 75 and 100 horse power.

b. Expansion designed to meet the demands of conservative estimates may not offer prospects of reducing per unit costs at all comparable with those promised by more elaborate projects.

On the financial side it must furthermore be realized that capital issues are rather exceptional incidents in the financial experience of most corporations. The tendency must always be to make "ample" provision for the future. Once, however, the means of financing are assured, it becomes difficult or impossible to avoid succumbing to the entreaties of the engineer.

The economic world in which we live is unfortunately not one in which, without some sort of arbitrary control, we may count upon a harmonious development as between capital equipment and final prod-

ucts, save perhaps in the sense that disturbances in the one field must be communicated to the other. It does not take long, furthermore, for an "improvement" boom to alter radically the productive powers of our leading industries. The total replacement value of the country's plant equipment of all types—including factories, railroads, commercial buildings—probably does not exceed the income of the people in a single average year. To stagger plant improvement between industries, so that intensive evil conjunctures may be avoided, requires carefully exercised control in periods of normal or supernormal activity. The encouraging influence of abundant credit may be insufficient after serious reaction has developed to secure any marked degree of plant expansion. To be an effective planning agency, a central bank cannot therefore start from "scratch," in the sense that it is easy at any time for it to offset the mistakes of the past. The central banking system's efforts must be continuous and long sighted.

A brief recapitulation here may be helpful. For reasons indicated we are not likely to get during severe depressions as liberal credit policies as are desirable. Even if we could we should not have solved all of the problem. Effective stabilization requires also a restraining credit policy in the good years, particularly because of tendencies to overdevelop our plant equipment.

6. Although long-term investment demands may be highly significant with respect to informing us as to the processes by which rapid changes in the credit volume come to take place, it would be extremely difficult to base central banking policy predominantly upon developments in the field of capital investment. For one matter, methods of corporate financing constantly change, and it may become impossible to estimate the extent to which long-term issues have merely been taking the place of commercial borrowings which otherwise would be more extensively relied upon. As another practical difficulty, capital issues have displayed such extreme fluctuations in the past that it is practically beyond the statistician's power to make any reasonable estimate of a "norm."

7. There is much evidence, however, to support the contention that excesses in the issuance of long-term capital issues are largely the consequence of member banks' coming into possession of an abnormally large volume of lending power and vice versa; that, therefore, if the per year growth of member bank credit could be steadied mistakes in the use of long-term credit would be greatly reduced. Elsewhere I have compared fluctuations in the volume of member bank loans and investments with new corporate issues.[8] From this comparison it appears that from 1922 to 1929 the peaks in new corporate issues were reached at

[8] *Federal Reserve Policy, 1921-1930,* pp. 180-181.

about the same periods of time as those in which a curve of the volume of member bank credit attained temporary maxima. There is every evidence that any sudden increase in the lending power of banks tends to manifest itself for the time being largely in long-term investment channels.

In conclusion, therefore, full recognition of the significance of long-term investment credits does not seem to require us to lay down any different principle for the guidance of central banks than we would be obliged to formulate if the only type of credits extended by the banking system were those of a short-term commercial character. Long-term investment excesses seem to be largely the consequence of an unsteady growth in the total outstanding volume of member bank credit. The statistical basis for supporting the policy of steadying the growth of credit has been elaborately supplied by Snyder. All I have tried to do here is to show how his thesis might be defended by analyzing the processes which must be controlled if the Reserve system is to operate successfully as an economic planning agency.

I am aware of the fact that to try to steady the growth of member bank credit could not be a policy that would be thoroughly satisfactory to idealists. Under it we would no doubt continue to experience minor business reactions and also some degree of fluctuation in the purchasing power of the dollar. In the last analysis this policy must rest on the premise that, in the absence of serious credit pressure, custom, contract, and friction tend to produce a reasonably stable level for all the prices that go to make the demand for credit what it is. This premise can never be exactly correct. But I do believe it squares more closely with the facts than other stabilization doctrines which are current, and if it could be accepted merely as an approach to central banking policy, there would be some assurance that, in any short period of time, serious maladjustments would not be occasioned by monetary causes. And if any part of the explanation seems involved some progress might be achieved simply by declaring to the banking administration that its basic responsibility consists in keeping always in a position to accelerate or retard the flow of bank credit. For, when the flow of credit becomes too rapid, an excessive volume of debts is created; and when the flow of credit becomes deficient, old debts cannot be discharged.

Objections to the conclusion herein supported, which might be developed from an analysis of international factors, cannot here be considered. But to those who see inescapable difficulties from this source, I would suggest that the attempt be made to compare its probable consequences in—say—the period 1922 to 1928, with the actual policies that were promulgated. I would also ask to have reviewed the whole question whether American economic developments do not exert far more

influence upon those of the entire world than we as yet have even begun to surmise. If the results of such an exercise are not favorable to our contention, I would then raise the further question whether gold standard currency systems do not require modification. But the alteration of the rules of the gold standard game is not the immediate task. In our thinking we must first conceive of an adequate domestic policy before we are justified in proposing efforts designed to accomplish grandiose international objectives.

FEDERAL RESERVE POLICY IN WORLD MONETARY CHAOS

By James Harvey Rogers
Yale University

Never in recent years have the monetary systems of the civilized world been in a more chaotic state. Even the post-war inflation period brought hardly more extraordinary or more tragic conditions.

The British Empire and the so-called "Sterling Group" remain on depreciated paper standards with no clear-cut plans for the future. France and the United States continue to hold approximately two-thirds of the world's monetary gold stock, while no inconsiderable portion of the remaining one-third is piled up useless and virtually sterile in Belgium, Switzerland, and Holland.

Meanwhile, business activity and commodity prices throughout the world have sunken to levels completely incompatible with the existing volume of debt. The ruthless, exceedingly painful, automatic adjustment of this volume of debt to the low level of prices moves slowly onward, carrying with it the wrecked fortunes and the ruined lives of no inconsiderable portion of the world's best citizens. In such a situation Federal Reserve policy has been faltering and frequently unsatisfactory.

For almost two years and a half after the depression began, the general principle upon which policies were based seemed to be: "The body economic will heal itself, once 'normal' and 'desirable' liquidation has run its course." Hence, while very commendable and effective action was frequently taken to "cushion" too rapid movements under conditions of panic and often of hysteria, it was not until the spring of 1932 that action directed toward arresting the liquidation process itself was instituted. The effects of this constructive change in policy should receive, therefore, careful evaluation.

The theory of open market purchases of the Federal Reserve banks in the minds of those who have undertaken to analyze the effects can be stated very briefly as follows:

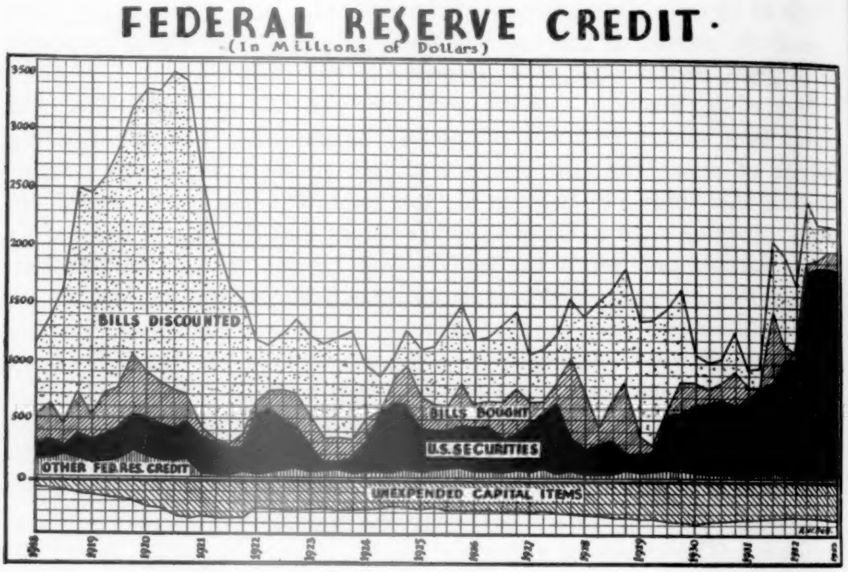
The new funds put out by the open market purchases of the Federal Reserve banks go very quickly to the reserves of the commercial banks. To the extent that excess reserves are thus built up, pressure is brought upon the commercial banking system to expand its loans and investments—but in depression periods primarily its investments. So far as statistical evidence is available, this contention is borne out by the recorded actions of the banks. Since, however, large security holdings of American banks date from the war and post-war years, such evidence is necessarily very scanty.

Any considerable purchases of securities by the banks would be sure

to strengthen the markets for the securities bought and this gradual strengthening could usually be depended upon to stimulate buying on the part of other institutions and of individuals.

Finally, the rebuilding of the security markets would furnish the means of floating securities, the proceeds of which would be speedily used in the purchase of raw materials, the payment of wages, and in other ways destined to put the new purchasing power into the hands of spenders. Thus the success of the policy depended on the use of the new funds by the banks, on a sufficient improvement in the securities' markets to float new securities, and on the continued existence of satisfactory securities to be floated.

Chart I



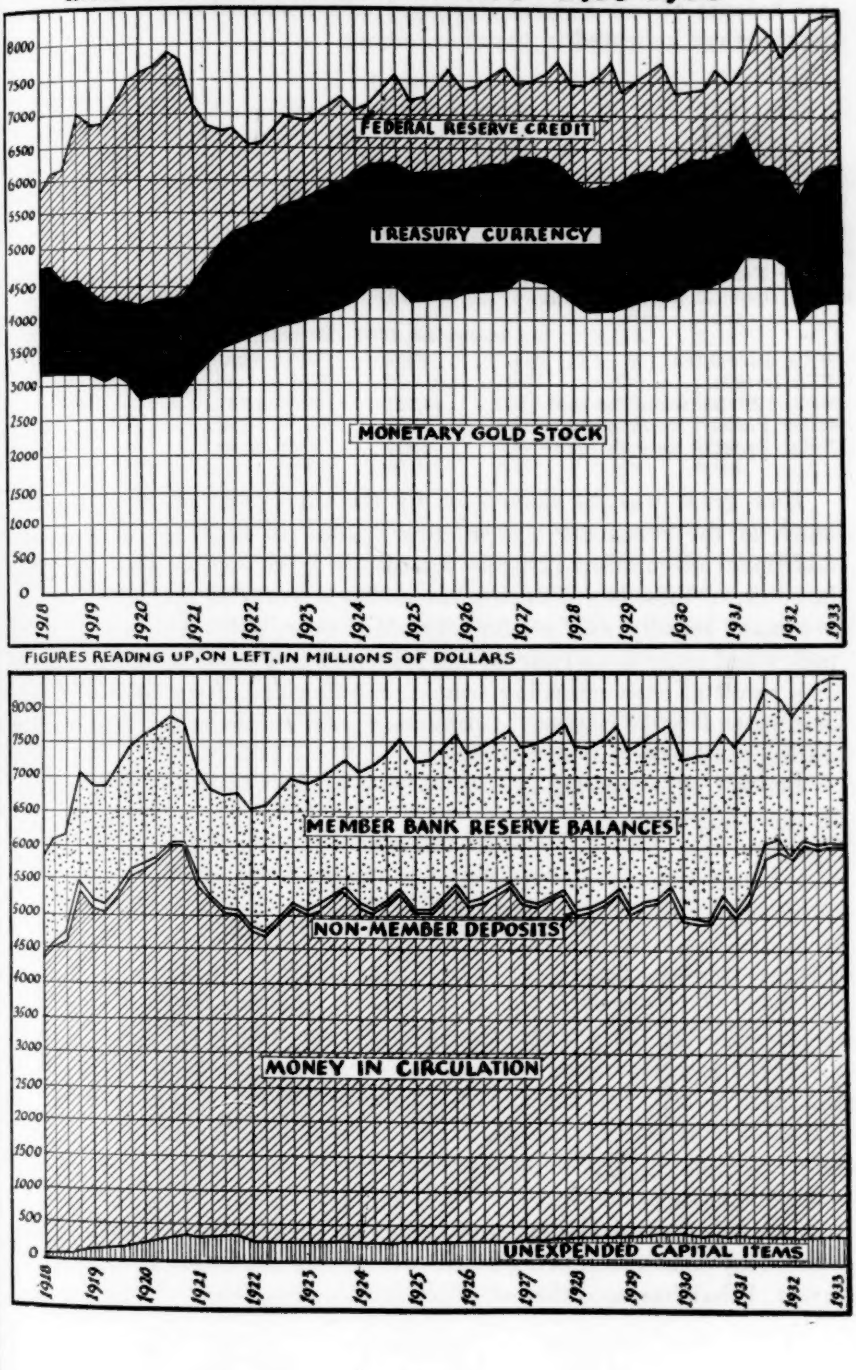
When I talked on this subject before you last year, the third requirement was still amply fulfilled. I then advocated strongly the open market policy in the hope that the banks would invest the new funds turned over to them and that in turn a securities' market sufficiently strong and broad to provide for gradually increasing flotations would soon result.

Let us examine what has happened. Reference to the accompanying chart and table will be helpful.

Evidently, as anticipated, a large portion of the new funds were utilized in paying off borrowings at the Federal Reserve banks by the

Chart II

THE CREDIT BASE and its UTILIZATION ▾ 1918-1933



member banks and a smaller portion through the cancellation of bill holdings of our central banking institutions. Nevertheless, a very large net balance of new Federal Reserve credit remained and was consumed in the ways indicated in the chart above.

TABLE I

FEDERAL RESERVE CREDIT

(Weekly average of daily figures)
(millions)

	February 27, 1932	August 13, 1932	Change
Bills discounted	$842	$458	$—384
Bills bought	139	38	—101
United States securities held	740	1,851	+1,111
Other Federal Reserve credit	31	16	—15
Total Federal Reserve credit	1,752	2,363	+611

	August 13, 1932	December 14, 1932	Change
Bills discounted	$458	$284	$—174
Bills bought	38	34	—4
United States securities held	1,851	1,851	...
Other Federal Reserve credit	16	20	+4
Total Federal Reserve credit	2,363	2,189	—174

How great was its absorption by the early gold outflows and how much of the remainder was in turn utilized to meet the demands for additional circulation (largely hoarding) is clearly evident. In spite, however, of these heavy drains, the excess reserves of the member banks increased rapidly and continually. Moreover, after the open market policy had come to an end, further increases continued to appear partly as a result of cash returning from circulation (i.e., from hoarding) and even more largely because of persistent gold inflows which again set in during the latter half of the year.

The net effect on the excess reserves of the member banks is given in the table below.

TABLE II

EXCESS RESERVES OF MEMBER BANKS

(millions)

Monthly Averages of Daily Figures

1932

January	35.4
February	43.8
March	59.0
April	152.1
May	277.1
June	234.4
July	204.4
August	269.9
September	345.5
October	435.8

Such an accumulation of excess reserves (or idle funds) would, under normal circumstances, bring much pressure on the banks to lend and to invest. What has been the net effect in this direction?

TABLE III
LOANS, INVESTMENTS, AND DEPOSITS OF REPORTING MEMBER BANKS IN LEADING CITIES
(millions)

Last weekly report in 1932	Loans and investments	Loans	Total investments	U. S. securities held	All other securities	Net demand plus time deposits
January	$19,992	$12,855	$7,137	$3,841	$3,296	$17,224
February	19,606	12,609	6,997	3,806	3,191	16,786
March	19,354	12,211	7,143	3,920	3,223	16,621
April	19,033	11,882	7,151	3,884	3,267	16,829
May	18,994	11,588	7,406	4,084	3,323	16,831
June	18,754	11,263	7,491	4,254	3,237	16,467
July	18,334	10,992	7,342	4,136	3,206	16,346
August	18,539	10,796	7,743	4,535	3,208	16,645
September	18,907	10,706	8,201	4,960	3,241	16,869
October	19,118	10,516	8,602	5,298	3,304	17,195
November	19,002	10,413	8,589	5,266	3,323	17,413
December 7th	18,841	10,364	8,477	5,226	3,251	17,196

From the table above it is seen that loans and investments together, as well as deposits, reached a low point in July, 1932. Since that time, while loans have continually declined, investments continually increased until the end of October. Likewise, deposits through November continued their mild upward trend, being now a little less than a billion dollars above their July low.

Thus can be enumerated the following highly beneficial accomplishments, resulting largely from the accumulation of bank reserves, which in turn are closely related to Federal Reserve policy and to the succeeding gold inflows:

1. Disastrous bank liquidation has at least been arrested and in its place (through October) came a mild gradual credit expansion.

2. The national government has been enabled to borrow in large volume at very low rates.

3. The market for the highest grade of non-government securities has continually improved.

4. Flotations of such securities proceed with little difficulty and are now readily undertaken—when available—by the investment bankers.

Nevertheless, the credit expansion so far has not proved sufficiently rapid to bring substantial relief. The banks to whom the new funds have come have not distributed them quickly enough and in sufficient volume to recreate security markets strong enough and broad enough to float new issues in large enough quantities to bring recovery. In other words, the gap between the distributors of credit and its users is still largely unbridged.

What are the reasons for the slow working of so eminently constructive and so highly desirable a relief measure? They are many and some of them are easily traceable.

The condition of the banks themselves is a powerful retarding influence. Having taken numerous and extremely dangerous losses in all parts of their portfolios—especially in security holdings—and many of them being in precarious financial condition, they do not dare run the risk of further losses. Hence, their tremendous demand for short-term government securities and their great accumulations of idle reserves.

The condition of business and of other big borrowers is an equally formidable obstacle. So precarious is the situation of our railroads, of many of our municipalities, and of no inconsiderable portion of our public utilities—not to emphasize the almost hopeless condition of a large part of our mortgage debtors—that bank purchases of such securities are naturally made only with the greatest of trepidation. Hence, continued strength in the securities' markets has so far been confined to the highest grade bonds only.

Meanwhile, the ever more clogged conditions of trade and ever more drastic reductions in our exports throw a continually darkening pall over the prospects of sustained recovery.

Finally, the unbalanced national budget, by threatening the securities' markets with large government flotations, causes the investment bankers to pause before undertaking other issues of much less security.

Under such conditions, not only have the markets for securities below the "gilt-edge" classification not developed, but many issues tentatively arranged for with investment houses, to be floated as soon as a satisfactory bond market should appear, have gradually dried up.

Thus, while this mildest of inflation measures—"reflation" some prefer to call it—has done much to arrest the downward movement and to create economic stability, its ultimate success in bringing relief from depression is still in doubt. It would seem the part of wisdom, therefore, to visualize a possible continued inadequacy of existing constructive influences and to discuss the (I trust) hypothetical consequences.

Should failure occur, what is its significance? Does it mean the end of the capitalist system—as many contend—or are there other ways out? While our economic technique and our data do not perhaps furnish the basis for a conclusive answer to such questions, much of pertinence can be said.

The credit expansion policy so far applied is perhaps the mildest form of inflationary device. Indeed, it is a type of inflation over which a large measure of control is at all times held, since the securities bought by the Federal Reserve banks could—under almost any foreseeable conditions of inflation—be sold, and the effects of the policy be thus checked.

For success, however, it requires the smooth operation of a large portion of the capitalist machinery, the breakdown of which at critical points will interrupt the effectiveness of the measures adopted. That a temporary break has developed in the form of the gap left by the failure of the banks to distribute the funds to spenders, no one can dispute. Moreover, if this gap remains unbridged, the capitalist system will not be able to utilize these particular devices to bring about recovery.

When one admits such failure, however, he—perhaps unconsciously—admits many other things. Let it be carefully noted that the operation of this inflation device is—except for temporary though often very important, psychological concomitants—identically the same as that of gold imports of the most influential kind. This is easily seen. New gold imported on commercial account, for example, has as its immediate and direct effect, the swelling of the reserves of the importing banks by the amount of the imports.

If, and only if, these increased reserves lead to an expansion of bank credit, is there any resulting effect on business activity and on prices. When reserves, as at present, are ample for any emergency, the indirect effects of the gold accumulation may be neglected. Extensive gold inflows, under present conditions therefore—except for often important psychological effects—will do no more and no less than an equal purchase of government securities by the Federal Reserve banks.

Lest, however, the boosting effect of nationally successful inflation itself be overstated, a word should be said as to the operation of more extreme types of this often dangerous remedy. Moreover, in order to bring into bold relief the points in which I am especially interested, I shall proceed to follow step by step the processes of the purest, simplest, and perhaps most absurd type of inflation.

Suppose, for example, that the government should send a newly-printed ten-dollar greenback to every man, woman, and child in the United States on the first day of each month for the next six months. Thus would be distributed monthly—presumably largely to spenders—\$1,200,000,000. And, thus, to that amount—but to that amount only—would the gap recently left open by the partial failure of the banks to distribute to spenders the funds turned over to them by the recent Federal Reserve policy be bridged. The subsequent and much more important effects—and this is the point I wish to emphasize—would come from identically the same source as those from gold imports or those from Federal Reserve open market purchases; viz., from accumulations of excess reserves in the banks. In detail: the new greenbacks, after their first turnover, would be largely deposited in commercial banks, which would in turn send them to the Federal Reserve banks, thereby increas-

ing member-bank reserves—as well, incidentally, as reserve cash in the Federal Reserve banks. The further inflation, therefore, as now, would depend upon the loan and investment policies of the member banks. Moreover, since the banking system is able normally to expand its credit seven to ten times the new reserves thus received, this secondary inflation is correspondingly more significant and more dangerous.

Another type of inflation frequently spoken of today has its major though secondary impact in the same place. Psychological influences again neglected, reducing the gold content of the dollar, to the extent that it would succeed in bringing stimulus to trade and prices, would act directly through the foreign exchange markets. Because of the reduced value of the dollar in terms of other money units, foreign buying of American securities and commodities (in so far as trade barriers and exchange restrictions would permit) would provide the sole initial impetus. The resulting gold inflows—to the extent that they were allowed by gold-losing countries—would have as their major direct effect the further accumulation of excess reserves in the hands of the commercial banks. On the probable assumption that the profit from the reduction in the gold content of the dollar would accrue to the national government, and by it be promptly spent, a further bridging of the gap to the extent of this profit would ensue. Such new expenditures, too, representing, as they would, a direct expansion of Federal Reserve credit would in turn add a like accumulation to excess reserves of the banks. Hence, except for the depressing effects in other parts of the world of our absorption of a still larger part of the world's monetary gold stock, the major effects on business and on prices would again depend on the loan and investment policies of our commercial banks.

It is clear, therefore, that even inflationary devices, unless carried to dangerous lengths, depend for their success on bridging the same gap as that now defeating the expansionary influences already in operation.

The direct—but perhaps unconscious—attempt to bridge this all-important gap by governmental action has largely failed. The reasons are obvious. In the prosperous years 1926-29, the monthly new capital flotations in the United States—other than refunding—averaged but little less than $700,000,000 ($676,000,000), and in 1929 were more than $850,000,000.

Since few concerns, business or other, borrow long before they are ready to spend, such flotations represent largely the turning over of funds to quick spenders. In addition, a great part of such early spending is apt to be for raw materials and for labor. It is thus, through credit, that the capitalist system sets in motion the processes of production and consumption.

When the Reconstruction Finance Corporation undertook to bridge

the gap left open by the "temporary" failure of the capitalist machinery, it soon became evident that the bridging would be hopelessly inadequate. In my opinion this is almost inevitable. It is government money that is being spent and patriotic citizens, such as the officials of the Reconstruction Finance Corporation, in charge of its spending are sure to release it sparingly and only on good security. A railroad applying for $100,000,000 loan may, if lucky, get $60,000,000. Hence, in spite of the huge lendings of this government agency, this bridging—combined with the small but improving private flotations—has so far not been more than adequate to arrest the downward drift in business, in prices, and in employment. Moreover, if solely relied upon, that it will continue inadequate seems to be sure. Under such circumstances, and in the absence of substantial recovery in the private capital markets, our very rapid drift toward state capitalism is obvious. And, in my opinion, state capitalism is but next door to state socialism. The drift instead of slackening in speed seems to become more pronounced as time passes. As the government becomes each day more deeply involved as a creditor to American business, the chances of its ever being able to pull itself out become more and more remote.

Should the gap not be adequately bridged therefore—an assumption which I am not yet prepared to accept—what can be said as to our present situation? It would seem desirable to make the diagnosis while a drastic operation still promises recovery for the patient.

If I may use the exact, rigorous terminology of the Lausanne Mathematical School, I should say that at least temporarily our economic equilibrium is broken. To American audiences such a statement doubtless means little. In this country, equilibrium is a term so generally and so carelessly used that it has come to mean almost anything and therefore nothing. In contrast, Vilfredo Pareto used it in a very specific sense indeed. By him a state of equilibrium is defined as that state any departure from which sets up an aggregate of influences tending to restore the original state. Evidently, under such a definition, the sea is in a state of stable equilibrium, as is a lake, so long as its boundaries are undisturbed. Also, hitherto, under the capitalist system, so stable has been our own economic equilibrium, that any disturbance could be depended upon gradually to produce its own cure. No doubt, this is the basis of the well-established opinion among business people that the body economic will cure itself if only let alone.

That such an assumption can no longer be made with confidence should now be clear. If the above-discussed all-important gap cannot be bridged, we are apparently slipping off into another largely undetermined and unforecastable economic organization.

Are there any means of more adequately bridging the fatal gap? The

answer is that there are many. Some of them are, however, of the nature of a major operation, which must be performed by highly skilled surgeons. Yet unless mild remedies are very promptly and adequately applied, resort to the more drastic treatment may soon be required by political necessity.

Furthermore, let it be added, and continually emphasized, that because of the make-up of our money and capital markets, any serious threat of national inflation—however well controlled—is sure to bring grave financial trouble. Indeed, unless international in scope, monetary measures of a radical character are certain—even before passed by Congress—to precipitate panic in our great investment centers. The sudden withdrawals of foreign balances, sales from abroad of American securities, capital flights from this country and resulting large gold outflows would reproduce in intensified form the panicky conditions of late last spring. Meanwhile, the beneficial effects of the plentiful money policies of our Federal Reserve banks, supplemented by the recent gold inflows, would be again interrupted. Hence, the obvious necessity of attacking the problem on an international scale.

The World Economic Conference is immediately ahead. Moreover, in spite of the Ottawa agreements, never in recent years has the feeling in this country toward the British people been more cordial. My proposal is, therefore, that this good feeling be preserved and harnessed to no less an end than that of bringing the world out of the present depression.

Specifically, the proposal is as follows: let the American and the British governments enter immediately into a gentlemen's agreement to co-operate in every way politically and economically possible to rid the world gradually of undesirable and unnecessary trade barriers, to raise world prices to a level at which the capitalist system can again function, and thereafter to maintain such a level; at the forthcoming World Economic Conference, let the British and the American governments, with the participation of as many others as possible, ratify such a gentlemen's agreement.

The emphasis upon the gentlemen's agreement is purposeful. The British are sure to regard such an agreement as binding and would move continually year after year in the directions agreed upon. Their actions in turn would bring upon the American government, the American Congress, and the Federal Reserve authorities the healthiest, most friendly, and hence, the most effective type of continued co-operation.

In my opinion it would be a great mistake to attempt, instead, any sort of agreement on specific policies to be adopted. Those suitable and feasible in England might be politically completely impossible in this country or in Australia. Moreover, a discussion of specific means to

the ends desired is sure to throw the emphasis in the wrong place and is apt to entail such great delay as to kill the effectiveness of the remedy when and if adopted.

At the World Economic Conference, it seems probable that the co-operation in such a constructive policy could be anticipated on the part of the British Empire, most of the northern countries, Germany, Switzerland, Italy, and possibly of Czecho-Slovakia.

Finally, in view of recent happenings in the bitter controversy over war debts and of the great publicity given to them all over the world, these obligations—probably worthless as financial assets—have apparently taken on a new value as constructive bargaining instruments. Having read about them daily in the headlines for more than four weeks, having "cussed" and discussed them, argued, quarreled and fought over them, the publics in the debtor countries have no doubt concluded—however erroneously—that they are far from dead. Moreover, with the statesmen in all countries seeking a formula for disposing of such troublesome obligations in exchange for a truly constructive program of world recovery, some such plan as the above would seem to meet with many of the political necessities involved.

If the American delegation could go to the World Economic Conference with a constructive program and with these debts to bargain away, much might be accomplished in bringing world-wide relief.

DISCUSSION

E. W. KEMMERER.—Mr. Reed seems to contemplate the necessity of an increasing degree of national economic planning, and maintains that instead of creating new bodies to do this work, we should utilize for the purpose our existing Federal Reserve bank organization. He then raises the question as to the help that economists could render this organization in the carrying on of its work, and maintains that in this connection the work of economists "must not be crowded with ultimates when proximate realities will suffice," "must not be fashioned to accomplish too grandiose objects," and "perhaps should be little more than intelligent empericism." What I have to say will be concerned principally with this part of Mr. Reed's excellent paper, rather than with his later carefully guarded suggestions as to policy, with the majority of which I find myself in substantial agreement.

Assuming, for the sake of the argument, that a substantial amount of national economic planning is desirable—clearly a debatable assumption—are the Federal Reserve authorities a well-qualified group to conduct such planning? While these authorities have a fund of information that would be very useful to any economic planning group, and while under any scheme of national economic planning there should undoubtedly be a close liaison between them and the planning group, I doubt very much if the work of economic planning itself should be placed in the hands of the officials of the Federal Reserve system. In the first place, it does not seem to me that either in organization or personnel, the Federal Reserve authorities are particularly well adapted to this work; and in the second place, I fear that the placing upon them of this responsibility would have a deleterious effect upon the extremely important work they are now doing.

A personnel that would be well adapted to the duties of a central banking organization would not necessarily nor probably be well qualified for the duties of a national economic planning body. Most of the officers and directors of the Federal Reserve system are, and ought to be, bankers, merchants, and lawyers, whereas an economic planning board should have a large representation of economists, engineers, and industrialists. It would be expected that the governors of the twelve Federal Reserve banks would be bankers by profession, as they all actually are; but it is noteworthy that of the twelve governmentally appointed chairmen of the Federal Reserve banks, eleven today are bankers by profession, inclusive of one bank examiner. Among the six members of the Federal Reserve Board at the present time, there is one man who by profession is an economist, but there is not a single engineer nor man eminent as an industrialist. All twelve of the members of the federal advisory council are bankers. Taken together, these are the men who are most influential in determining the policies of our Federal Reserve system today, and presumably would be the ones who would dominate our national economic planning were this function turned over to the Federal Reserve authorities. It is true that the law provides for the election by the member banks themselves in each Federal Reserve District of three directors "who at the time of their election shall be actively engaged in their district in commerce, agriculture, or some other industrial pursuit." These men, how-

ever, constitute only three members of a board of nine; they participate in determining Federal Reserve policies only as directors who meet usually only for a comparatively short time at intervals separated by a number of days. As regards the policies of the Federal Reserve system, it is the continuously functioning personnel, like the Federal Reserve Board, its expert staff and the senior officers of the twelve Federal Reserve banks, that dominate.

If there is to be, in the interest of the general public, any national economic planning that is worth while, for a nation of over 120 million people, that normally does something like a trillion dollars worth of business a year, it will need to be done largely by men who devote most of their time to the job. This work can be no mere appendix to another job. It must be emphatically a vocation, not an avocation. To ask our Federal Reserve authorities to perform such a duty in addition to their present onerous Federal Reserve duties would be unwise.

Furthermore, any national economic planning body, no matter how constituted, will be the object of many political attacks and of continual political pressure from many sides. Our first and second United States banks went down under the onslaught of politics. Our Federal Reserve system has itself been the object of frequent political attacks. It is extremely important to the welfare of our currency and banking system, that the Federal Reserve system be kept as clear as possible of party politics. To impose upon it the function of a national economic planning body would almost certainly make it the object of increasing political criticism and pressure.

As to the nature of the assistance that economists should be called upon to give in the work of national economic planning, I cannot agree with Mr. Reed's contention that "perhaps it should be little more than intelligent empericism." National economic planning must concern itself to a large extent with broad policies of production and distribution, and, I venture to say, also with social policies of economic consumption. Many of these policies will contemplate long periods of time. Those responsible for this work will need to have a knowledge of economic history, both in the United States and abroad, and a knowledge of fundamental economic principles. They will need to be men who can see economic problems from the public welfare point of view, rather than from the points of view of private profit or special group interest. Sound theory and economic vision are requisites for economic planning. Who is to furnish these requisites unless it be the scientific economist? I would not belittle "intelligent empericism," but that will probably be furnished in abundance by any national planning body we are likely to have, consisting, as it almost certainly would, predominantly, of so-called "practical men of affairs." Such a body, moreover, acting collectively would normally be much more conservative and emperical than the average of its individual members. There is, in my judgment, a much greater danger of having too little vision than of having too much. Every forward movement will involve a compromise between empericism and vision. The economist can contribute to both, but his greatest contribution should be to vision.

I am in a somewhat difficult position in commenting upon the paper of Professor Rogers, as all I have seen of it is a "preliminary summary draft"

without the charts and without his discussion of the "significance of the situation" which he summarizes, and even this preliminary draft was not received until the day before Christmas.

I am skeptical about what Professor Rogers calls four "highly beneficial accomplishments, resulting largely from the accumulation of bank reserves, which in turn are closely related to Federal Reserve policy and to the succeeding gold inflow."

The first of the benefits he cites is that "disastrous bank liquidation has at least been arrested and in its place has come a mild gradual credit expansion." From the week ending February 27, 1932, to the week ending August 13, 1932, the average of daily holdings of United States Government securities by the twelve Federal Reserve banks rose from $740,000,000 to $1,851,000,000, representing an average weekly net increase of approximately $46,000,000. After the middle of August, this policy of gorging the market with credit was discontinued, and an opportunity was given the market to digest what had been fed to it. This was one of the most extreme attempts at deliberate inflation or reflation—if you prefer—that the world ever saw. However, whether the policy was a wise one or not—and of course no one knows what would have happened without it—the sequel at best has been very disappointing. Moreover, how far what little improvement that may have taken place is to be attributed to this policy and how far to other factors, it is not easy to say.

Take the case of bank suspensions, for example. To what extent was the improvement that took place due to the fact that the 3,402 bank suspensions between January, 1930, and March, 1932, had cleared out our weakest banks, and to what extent was it due to the enormous volume of loans to weak banks granted by the Reconstruction Finance Corporation and its predecessor, the National Credit Association? Between February 2 and October 31, loans aggregating $829,000,000 were authorized by the Reconstruction Finance Corporation to 4,706 banks and trust companies, while $46,000,000 more were authorized to receivers and liquidators of closed banks to aid in their liquidation or reorganization. And after all, how great is the accomplishment for which we are trying to allot credit? The number of bank suspensions was the lowest of the year during March, the month in which the heavy open market purchases of United States Government securities by the Federal Reserve banks began, and therefore presumably before their effects could have been substantial; and during four of the next eight months it increased over the month preceding, although it was much lower during this period, as were also the liabilities of suspended banks, than during the corresponding period of 1931. June, July, and October—all months in which the banks presumably benefited from the reflation program—were respectively the months of the second, third, and fifth highest number of suspensions for the first eleven months of the year.

The mild gradual credit expansion of which Mr. Rogers speaks appears to have been exceedingly mild. If you divide the first eleven months of the year into three periods—(1) January and February, before the expansion program began; (2) March to August 12, while the program was in full op-

eration; (3) August 13 to December 1, a period in which it was inoperative—the average of the weekly total loans and investments of all reporting member banks were for these periods respectively, as follows: (1) $19,976,000,000, (2) $18,974,000,000 and (3) $18,842,000,000. This was a decline, not an expansion. The principal effect of the heavy open market purchases of government securities on the member banks was a continual reduction of the member banks' indebtedness to their Federal Reserve banks, rather than an increase in the volume of credit which member banks extended to the public.

The second beneficial accomplishment Mr. Rogers mentions is that "the national government has been enabled to borrow in large volume at very low rates." The policy has certainly greatly facilitated and cheapened federal government borrowing at a time when much such borrowing was inevitable, and when the interest rate on short-time federal government borrowing, even without the reflation program, would presumably have been low, although nothing like so low as it actually was. From March 1 to November 22, the new indebtedness floated by the federal government was $2,581,000,000. However, whether this greatly enhanced facility will prove a blessing or a curse is a debatable subject, when it is obtained to such a large degree by the purchase of government securities directly by quasi-public central banks, and by national banks to expand their bank note circulation, and when it brings the interest rate on short-time government securities to the absurdly low figure realized last week of less than .1 per cent per annum.

The third and fourth beneficial accomplishments cited by Mr. Rogers are essentially two sides of the same thing. They are (1) that "the market for the highest grade of non-government securities has continually improved," and (2) that "flotations of such securities proceed with less difficulty and are readily undertaken by the investment bankers."

I have not the figures upon which Mr. Rogers bases these conclusions and do not know what particular high grade securities he has in mind. I will risk the assertion, however, that the improvement so far shown, in part at least, has been due to other forces than the open market purchases under consideration; as, for example, the increased confidence resulting from the work of the Reconstruction Finance Corporation and the discontinuance of the outward drain of gold. For all bonds listed on the New York Stock Exchange, the average price for March 1 of this year was 75.3 and for December 1 was 73.9, a decline of about 2 per cent. The United States Government bond group rose a little over 4 per cent during this period, while of the other five groups of the Stock Exchange's bond classification, the average price of three fell and of two rose. Moody's index of domestic bonds of Aaa rating declined almost continually from the beginning of the reflation period until the middle of the period, and then advanced until during the second week in August it stood almost exactly where it stood the forepart of March. It averaged 73.7 for January and February, 67.9 for the period March to August 12, and 80.4 for the period August 13 to December 23. It has been declining during the last two weeks.

The amount of new corporate issues of all kinds was the highest for the first quarter of the year—namely, before the reflation policy inaugurated in

March could have had any considerable effect—that it was for any quarter. It was almost negligible during the months of April to June, while the reflation was in full swing. July was the maximum month of the year, and October the third highest, while for September and November the figures were almost negligible. The new corporate bond and note flotations for these first eleven months of the year, amounting in round numbers to $299,000,000, were exceedingly small as compared with previous years, and were actually less than one-fourth of what they were in the corresponding eleven months of the bad year 1931, when they amounted to $1,418,000,000.

All in all, therefore, it seems to me that one must strain pretty hard to get much aid and comfort out of the "highly beneficial accomplishments" cited by Mr. Rogers.

One striking fact during this period of Federal Reserve bank credit expansion arising through the purchase of government securities is that, while these purchases were accompanied by comparatively little change in demand deposits of member banks, they were accompanied by an enormous increase of excess reserves and by very decided declines in the velocities at which deposits circulated. The average monthly net demand deposits of reporting member banks, and the average excess reserves for the three periods of 1932 were as follows:

	Deposits (Billions)	Excess Reserves (Millions)
January and February	$15.1	$ 40
March to July	14.9	189
August and September	14.3	308

For the same three periods, the average rates of deposit turnover, the so-called deposit velocities, were for New York City and for the other 140 cities for which the figures are available as follows:

	New York City	140 Other Cities
January and February	41.2	28.2
March to July	34.3	25.6
August to November	28.7	24.6

As more credit was made available to the member banks, the existing credit circulated at continually declining velocities. There were more credit dollars available but each credit dollar did much less work. Except in periods of great paper money inflation, the velocities of bank deposit circulation tend to vary with business confidence, rising as confidence rises and falling as confidence falls. The vigorous reflation program of the Federal Reserve banks, accompanied as it was by much agitation in Congress and outside for radical inflationary measures, weakened confidence among the very people upon whose initiative we must chiefly depend for economic recovery. The banks had more money to lend, but these conservative people, the only ones the banks cared to trust with these new funds, did not want to borrow them. They could not see anything that they could do with them safely and profitably. To a considerable extent, the very reflation operation which created these funds increased the business distrust that was making the conservative business public unwilling to borrow and the conservative banks unwilling to invest.

J. Franklin Ebersole.—The outlook for business recovery is not as bad as it has been painted. The outstanding favorable sign is the fact that the pessimist of yesterday is becoming the optimist of today.

Impatience is the besetting sin of those who criticize the failure of recent Federal Reserve open market operations to effect a quick recovery. Such impatience is the outgrowth of cloistered thinking and a belief in the practical possibility of prompt and perfect stabilization of business through the application of simple credit mechanisms. It is refreshing to note Dr. Reed's disclaimer of such a belief.

Even if the theory of economic control through credit mechanics be accepted as sound in reason, the achievement of current results from open market operations is conditioned upon at least three other factors, briefly labeled as: timeliness, amplitude, and background.

As to timeliness, could any advocate of national planning obtain through the necessary political measures a governing board more able than the Federal Reserve Board to anticipate business needs, with less expansion in 1927, more repression in 1928, and more stimulus in early 1930? To what extent is the lack of vigorous open market stimulus in early 1930 the cause of our present slow response?

The amplitude of the business swing must affect the lag of results. With such an unprecedented slump, our wait for recovery must be longer than usual. The Federal Reserve policy of forcing surplus reserves upon member banks is of comparatively recent, if not to say unduly postponed, application.

Amplitude resistance may be only another phase of deficient timeliness, but neither of these is the greatest limiting factor today. That factor is the changing background or framework of banking in the United States. Any form of credit control must "float" upon changing circumstance. The neglected events seriously conditioning the functioning of credit control by the Federal Reserve system are:

1. The Act of March 14, 1900, encouraging the establishment of many new, moderate-sized, national banks, thereby promoting the free coinage of a rapidly increasing volume of personal and private credits into deposit currency purchasing power.

2. The Act of December 23, 1913, enlarging the pyramid of deposit currency that could be built upon any given quantity of reserve material.

Either one of these acts was sufficiently inflationary to set up a chain of events distorting contemporary judgments of "normal" and requiring redress by a reaction more or less as great as that of the present crisis. Relatively too much attention has been paid to gold effects during the period of operation of these two acts, and too little to the effects of American deposit currency upon the world's gold problem.

Social-minded persons who fully realize the profound effects of expanding and of contracting the credit pyramid in a society using deposit currency chiefly as its medium of exchange have a difficult decision to make. Should further deflation be countenanced? Having closed about 11,000 out of our 30,000 banks in the last twelve years, do we yet have too many banks? Should we rely upon open market operations solely when the whole frame-

work of bank credit is in collapse on the "firing line" where credit is and has been manufactured? Would a temporary emergency measure for the guarantee of bank deposits restore confidence in depositor and banker and relieve pressure for further liquidation? Have we been raising the standard of good bank credits too rapidly in the past ten years? Will branch banking continue the deflation of bank credit at the source? Should we encourage the granting of enough new and unsound credits now so that with the consequent price rise the present unsound credits held by our banks will become sound? Will the new party in power next March grant numerous bank charters to its friends, and restore the free coinage of personal and private credits? When will the Reconstruction Finance Corporation's exchange of government credits for deposit currency exceed the concurrent shrinkage of personal or private credits in circulation? How much longer shall we wait patiently for results from open market operations before attempting a drastic reorganization of our banking or monetary structure?

To answer any one or all of these questions, with our accumulated knowledge of the subject, is not difficult; the problem is to obtain immediate and necessary social action to restore the shattered framework of our banking system and to recreate the evaporated deposits.

SESSION ON THE TARIFF

TARIFF REFORM: THE CASE FOR BARGAINING

By Percy W. Bidwell
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Tariff reform, meaning tariff reduction, after twenty years of quiescence, is again a live issue. Its resurrection is one of the manifold by-products of the depression. Two and one-half years of falling prices, unemployment, and bank failures following the enactment of the Smoot-Hawley tariff have demonstrated that "protection" and "prosperity" are not synonymous. In fact, in a large section of the public mind high tariffs are now closely associated with business depression. During the recent presidential campaign the Democratic leaders did their best to make this association of ideas even closer. Economists have done their bit, and some business men, too, have denounced the exaggerated protectionism of the Smoot-Hawley tariff as responsible for deepening and prolonging the depression. It would appear, therefore, that the present was an opportune time to initiate tariff reform.

But the practical difficulties in the way of tariff reduction are many and not easily overcome. During a period of trade stagnation tariff beneficiaries oppose bitterly all attempts to reduce their protection. To the man in the street, seeing only the effect on imports but neglecting exports, it would seem as if tariff reformers were planning to add to the already staggering burden of unemployment. Everyone knows that even in prosperous times tariff revision causes business uncertainty; during depression might not the threat of increasing competition from abroad nip in the bud the tender flower of business recovery? Economists it is true might indicate numerous tariff items that could be reduced without serious results, but American business men have always attached exaggerated importance to tariff protection. And it is a fact that no important revision downward of tariff rates has ever been made during a period of business depression. On the contrary, hard times regularly stimulate the demand for higher tariffs and the depressions of 1893-96, 1907, and 1920-21 were followed by upward revisions of rates. In fact, the present Congress in its first session levied new duties on coal, oil, copper, and lumber. The depreciation of foreign currencies is a feature of the present depression which offers an added obstacle to tariff reduction. During the past twelve months additional duties to offset exchange dumping have been insistently demanded by numerous American industries. Difficulties and obstacles such as these could be overcome if the party which will assume power in March, 1933, were solid for tariff reduction. But since the Underwood Act was passed protection has made large inroads into the Democratic ranks.

Recognition of the fact that in the present business and political situation general tariff revision by Congress is not only impossible but undesirable from many points of view is responsible for the new direction of tariff reform. In the bill (H.R.6662) introduced by Representative Collier at the first session of the present Congress three proposals were made: (1) the abolition of the president's power to change rates of duty under the so-called flexible provisions; (2) an international conference to consider lowering of excessive duties, the abolition of prohibitions, quotas, and other emergency restrictions; and (3) the negotiation with foreign governments of reciprocal trade agreements under a policy of mutual concessions. This bill comprised the hopes and aspirations of the tariff idealists in the Democratic party. It passed both houses without important modification of its principal features (except for the provision for congressional ratification of all treaties concluded). President Hoover vetoed it and the veto was sustained.

But the reform program was not finally disposed of by the presidential veto; it reappeared as the tariff plank in the Democratic National Platform, which read: "We advocate a competitive tariff for revenue, with a fact-finding tariff commission free from executive interference, reciprocal tariff agreements with other nations, and an international economic conference designed to restore international trade and facilitate exchange."

In the campaign, the part of the reform program receiving special emphasis was the proposal for reciprocal tariff agreements. This was usually spoken of as "reciprocity" or tariff bargaining. Governor Roosevelt urged tariff reciprocity in several of his addresses. At Seattle he advocated "a tariff policy based in large part upon the simple principle of profitable exchange arrived at through negotiated tariffs with benefit to each nation." Various exporting interests took up the cudgels for tariff bargaining as a measure to remove retaliatory tariffs which they believed were keeping American products out of foreign markets. A World Trade League was formed in New York for the purpose of advocating tariff bargaining.

Considerable publicity was given President Nicholas Murray Butler's support of the new policy. In an address before the Economic Club of Chicago, April 15, 1932, President Butler said, "If the American government would begin promptly the negotiation of reciprocal commercial treaties with other great industrial nations, treaties drafted with a view to bringing about very substantial reductions of prevailing rates of duty, great gain would result both at home and abroad. Other countries would with certainty eagerly follow the lead of the United States."

I should like to consider now what is implied by tariff bargaining

and reciprocity and what their possible uses may be in the present situation. In popular usage the terms are synonymous; specialists, however, adhere to the classification established by the United States Tariff Commission in its report of 1919 on *Reciprocity and Commercial Treaties*. They use the term "reciprocity" in a special sense to denote a commercial agreement of an exclusive character between a pair of countries. In our own experience reciprocity treaties have been influenced strongly by political circumstances. The Commercial Convention of 1902 between the United States and Cuba is a good illustration. Such agreements as I have said are usually exclusive in character. The concessions contained in them are not automatically generalized to other nations through most-favored-nation clauses. "Tariff bargaining," on the other hand, is a more general term. It has been used to describe all of the methods, including offers of concessions and threats of penalties, by which a nation strives to secure more favorable treatment for its commerce at the hands of other nations. Bargaining may have as its object specially favored treatment and may lead to mutual reductions of duties, or it may aim at the removal of discriminations. In the latter case its object is merely to secure equal treatment. Since nations of the first rank generally pledge to each other equal treatment in commercial treaties, the aim of bargaining is usually the reduction of duties by special concessions, but these are not necessarily exclusive concessions. Since 1922 the tariff laws of the United States have provided for the imposition of penalty duties as a means of enforcing equality of treatment. Usually we do not think of that as a bargaining device. The proposal for tariff bargaining is a new departure in that it contemplates the offer by the United States of concessions from its statutory rates of duty in exchange for equivalent concessions from other countries.

On its face the proposal is attractive. The method of concession seems to breathe a mild spirit into an atmosphere now surcharged with retaliation and strife. Furthermore, tariff bargaining is almost universal, nowadays. Continental nations have long practiced it, and even in England which long maintained a single-column tariff, the Board of Trade is now authorized to make concessions from the new protectionist duties for bargaining purposes.

Tariff bargaining has often been condemned for the reasons which President Hoover gave in his veto message of May 11; namely, that the policy involved complex and long drawn-out negotiations without resulting in any important benefits with respect to foreign trade. This view finds support in the significant report of the United States Tariff Commission to which I have already referred. The Commission's survey of the history of American commercial policy showed that tariff bargaining had accomplished little. The Commission emphasized particu-

larly "troublesome complications which the policy of special arrangements inevitably produced." It spoke of unpleasant controversies and international friction. Congress adopted the Commission's attitude, and in the Act of 1922 no provisions for tariff bargaining were incorporated. It is worth observing, parenthetically, that among the considerations which moved the leaders in Congress to reject bargaining was one which the Commission did not stress and of which it would not have approved. The political watchword at the time was "return to normalcy" and in foreign affairs normalcy meant isolation. With such an attitude a single-column tariff was more in accord than a bargaining tariff.

I shall not attempt to go over again the ground which has been so well covered in the Commission's report. I think we may take for granted that the facts which are set forth there are accurate and the conclusions which the Commission drew from them were warranted at that time. But in the thirteen years which have elapsed since the Commission's report was published, changes of great significance have occurred both in the commercial policy of the United States and in our economic relations with foreign countries. I wish to examine now whether these changes warrant reconsideration of our attitude toward tariff bargaining. Is it possible that, if the same Commission were preparing a report for Congress in 1933, its conclusions might be different from those of 1919?

In 1919 we had just emerged victorious from a world war. For five years our export trade had been experiencing unheard-of prosperity. Exporting firms had no difficulty in selling anything and everything in the markets of Europe, Latin America, and Asia. Prices were sky-high and there was as yet no indication of the approaching crisis of 1920 and 1921. Our foreign investments had been swelled by the war-time loans but were still modest compared with the (nominal) value of our present holdings abroad. Then came the boom of 1922-29. Stimulated by an aggressive policy of government aid, our manufacturing industries found new possibilities in foreign markets. Liberal lending by American investors gave foreigners the means of paying for enormous quantities of American goods.

But this happy situation has now disappeared. The stoppage of the flow of capital to European and South American countries has dried up their purchasing power. Debtor countries in their efforts to balance their international accounts have taken drastic measures to reduce imports. European countries have raised tariffs as a measure to protect agriculture and in the hope of reducing unemployment. Thus government action has accentuated the decline in prices and in the volume of international exchanges. American exports have been hit severely.

World trade declined 40 per cent in the years 1929-31 and American exports fell off 53 per cent. The value of American goods exported in 1932 was $1,618,000,000 as compared with $2,424,000,000 in 1931 and $3,843,000,000 in 1930. It is obvious that for the American exporter the situation in 1933 is far different from 1919.

In 1919 the change in the position of the United States in international finance from a debtor to a creditor nation, the world's greatest creditor, was under way, but the process was not fully accomplished and the implications of the change as respects commercial policy were not fully appreciated. A new reason for tariff reduction has now arisen. The American investor in foreign securities has joined the American exporter and the American consumer in demanding lower duties on foreign goods. How else can interest and capital repayments be received?

Let me say at this point that to my mind neither the decline of American exports nor the plight of the American holder of foreign securities are the facts of chief significance. The new economic situation which in reality justifies a reconsideration of bargaining is the general collapse of international trade. The policy which at this juncture will in the long run be of greatest benefit to any country is the policy which fits in best into co-operative action for world recovery. We must consider therefore whether a change of policy by the United States might not induce or at least facilitate a general relaxation of trade restrictions throughout the world.

Since 1919, the American government has inaugurated a new commercial policy or perhaps I should say that it has given a new and more formal expression to a policy which had been in process of development for some time. I refer to the announcement in 1923 of the policy of "equality of treatment." The policy has found practical expression in the adoption in all commercial treaties and executive agreements concluded since that date of the most-favored-nation pledge in its unconditional form. Another feature of the new policy was the provision in the Tariff Act of 1922 (re-enacted in the Act of 1930) of penalty duties as a means of protecting American commerce from discriminatory treatment by foreign countries. In this new set-up, bargaining found no place. In fact it was frankly rejected. The United States offered equal treatment to all and insisted, or attempted to insist, upon receiving equal treatment from all.

Two questions arise at this point: (1) Is there a conflict between the policy of equality of treatment and the policy of bargaining? (2) If such conflict exists, is it worth while to modify our policy so as to harmonize it with bargaining practices?

There is no necessary conflict, it seems to me, between bargaining and the use of penalty duties to protect American commerce against

discriminatory treatment by foreign countries. As a matter of fact the determination of what constitutes discrimination is such a nice matter, and the penalty duties are regarded as such a drastic measure, that they have never been used. At present the use of import quotas, exchange restrictions, and the like, have upset the old criteria of equal or fair treatment, making the proof of discrimination practically impossible. It is quite possible that under these abnormal conditions, supplementing penalties with bargaining might produce better results than have been secured by the penalty method alone.

In discussing the relation of bargaining to the policy of equal treatment, two features of this policy should be distinguished: (1) the single-column tariff and (2) the unconditional treaty. Should we, in the present state of our treaty relations, adopt a bargaining policy, our single-column tariff would be replaced, at least temporarily, by one with two or more columns of rates. But this situation would not arise because we had abandoned the policy of equal treatment but because we have as yet been unable to carry it out more than fragmentarily, as I shall presently explain.

More significant than the form of tariff schedules as a vehicle of our policy is the use of the unconditional form of commercial treaties. At present only eleven such treaties are in force with the following countries: Austria, China, El Salvador, Germany, Honduras, Hungary, Latvia, Norway, Turkey, and Yugoslavia. Of these countries only China and Germany afford markets of first-class importance. Other great trading nations have not been attracted by our offer of equal treatment, accompanied as it has been by high and rising duties.

In principle, it should be recognized, the giving and receiving of mutual concessions from established rates of duty is not inconsistent with the pledge of unconditional most-favored-nation treatment. This is the view of the United States Department of State expressed in reply to an inquiry from Senator Walsh with reference to the treaty pending with Norway.[1] But, as the Department pointed out, the concessions granted must not be exclusive. This is the essential difference between the old and the new treaties. And thus the use of the unconditional clause removes one of the major objections to tariff bargaining. As long as the United States insisted upon the use of the conditional clause, concessions from rates of duty were almost of necessity exclusive in character. This kind of bargaining was justly condemned for creating bad feeling among those nations who were not allowed to share in the reductions.

Under our new policy the benefits of any reductions achieved by bargaining would be automatically extended to each of the twenty-seven

[1] *Congressional Record, 72 Cong. 1 Sess.,* Vol. 75, No. 90, April 5, 1932, p. 7684.

countries to whom we have unconditionally pledged, by treaties and executive agreements, most-favored-nation treatment. Also, there is reason to expect that as soon as bargaining was adopted the number of unconditional treaties would increase, for foreign countries would then find it more worth while to enter this relationship with us. So far, then, from being in conflict with the policy expressed in the unconditional treaties, bargaining may be made an instrument of furthering that policy.

A second innovation in American tariff policy dating from 1922 raises a new and embarrassing obstacle to the re-introduction of bargaining practices. I refer to the so-called "flexible provisions" which first appeared in the Fordney-McCumber Tariff and were re-enacted with unimportant modifications in the Smoot-Hawley Tariff. These provisions give the president power to increase or decrease any rate of duty if an investigation by the Tariff Commission shows that the existing rate does not equal the difference between the domestic and the foreign costs of production. "Flexible" is a misleading word when applied to this scheme. In reality Congress laid down a rigid mathematical formula strictly limiting executive action in changing rates.

Cost equalization and bargaining seem difficult to harmonize. Obviously, absurd situations might arise if the president should continue to adjust rates to cost differences and Congress should set up an agency of its own to conduct bargaining negotiations. By concentrating in the executive the power of effecting both sorts of tariff changes, the conflict of powers would be avoided, but a conflict of principle would remain. This is not merely a priori reasoning. At least one instance is on record of an attempt to combine bargaining with cost equalization. In 1927 and 1928 during the tariff controversy with France, the American government promised by way of concession to submit to its Tariff Commission applications from French exporters for reduction on certain rates of duty. The applications were duly submitted to the Commission, but no cost investigations were ever instituted and no rates of duty were reduced. The narrow statutory limitation placed on the Commission's action made practically impossible the satisfaction of the French requests. The statute required, for example, that costs in the chief competing country should be ascertained and compared with American costs. The French request for reduction in the duty on peanut oil, therefore, would have had to depend for its satisfaction upon the investigation of costs, not in France but in China. In the case of silk velvet and plush ribbons, there was no domestic production of comparable articles and hence no cost study was possible, and the Commission could afford no relief. Finally there was always the embarrassing possibility, in those cases in which cost comparisons were possible, that

the Commission as a result of its investigations would find that a higher not a lower duty was necessary to equalize cost differences.

The authors of the Collier bill may have recognized that simply to superimpose tariff bargaining upon existing law would produce serious complications. But I suspect that other reasons explain their proposal to abolish the president's power to change rates of duty. According to their plan, which was in substance the amendment proposed by the late Senator Simmons to the Smoot-Hawley bill, applications for rate changes would still be received and investigated by the Tariff Commission but its reports would go to Congress which would exercise final power over rate changes. It is well recognized that the flexible provisions in the Act of 1922 never produced satisfactory results, and the modifications of the Commission's powers in the Act of 1930 amounted to very little. Of more importance was the reorganization of the membership of the Board. The new Commission has done much valuable work of a general investigational character, but as far as rate changes are concerned the experience of the past thirty months affords no ground for expecting that administrative rate making by the cost equalization formula will ever produce worth-while results. In the first session of the new Congress a bill proposing the reform of the flexible provisions along lines similar to those laid down in the Collier bill probably will be introduced. If the bill passes, Congress will resume full powers over the tariff and thus one of the principal objections to bargaining will have been overcome.

There is no opportunity here to discuss in detail the methods of bargaining. A suggestion made by Hon. David J. Lewis, formerly a member of the Tariff Commission, now a Representative in Congress from Maryland, has interesting possibilities. He has proposed that the United States should offer a flat reduction, say of 10 per cent, from its tariff to any and all countries that would be willing to make equivalent concessions. This suggestion has the merit of simplicity. It defines once and for all the extent of the American concessions. In fact it sets up a second schedule of minimum rates in addition to the rates now in force, which would then become the maximum tariff. Bargaining would ensue only in order to determine what concessions each foreign country should give from its tariff. A simple solution of this problem would be to insist that each foreign country should grant to the United States in return a 10 per cent reduction. Mr. Lewis suggests that the United States should re-enact our 1913 Tariff and as compensation other nations should go back to pre-war rates.

The existence of eleven unconditional most-favored-nation treaties and executive agreements with sixteen foreign countries introduces an element of complexity. As soon as any country accepted the American

proposal, each of the twenty-seven countries to whom we have pledged unconditional most-favored-treatment, would have the right to demand the minimum rates and without compensation. They would benefit by the reduction of the American tariff without being under obligation to reduce their own tariffs. Also, as soon as a single country had received from the United States a gratuitous concession, each of the fourteen countries to whom we are bound by conditional treaties could claim the benefit of the concession and without compensation. In order therefore to give maximum effect upon foreign tariffs to the American action it might be desirable first to terminate all executive agreements and then to invite all countries with whom we have unconditional treaties to conclude a new multilateral treaty by which concessions would be exchanged. Upon the conclusion of such a treaty no country not a party to it could benefit by the American willingness to reduce tariffs without itself making reductions. Also, through the operation of unconditional treaties with other countries many of their concessions to the United States would be generalized.

Finally, there are about fifty countries, including all of the British self-governing commonwealths, with which the United States has concluded no commercial treaties. As far as the new bargaining scheme was concerned, these countries would be in the same position as those with conditional treaties. They would have no claim to the minimum rates without making reductions from their own tariffs and when they did so many of such reductions would be perforce extended to other countries.

I have entitled this paper, "The Case for Bargaining." Its limited scope does not allow me to discuss in detail several substantial arguments against the practice, arguments which the pleas of changed economic conditions and changing commercial policy do not readily dispose of. It must be admitted that our constitutional separation of executive from legislative powers handicaps the American government in the negotiation of commercial treaties. Also it must be admitted that when a nation enters upon a bargaining policy there arises a tendency to set up artificially high rates, thus reducing the value of subsequent concessions. For this reason, tariff bargaining is not necessarily synonymous with tariff reduction, as is shown by the recent history of European commercial policy.

But it is my contention that given the will to reduce tariff barriers, bargaining facilitates and generalizes the reductions. Bargaining, I believe, may be made a means of hastening the reduction of the American tariff, a process difficult of accomplishment in any other way. I should not anticipate that the concessions secured from foreign countries would be sufficiently numerous or important to lead directly to a significant improvement in our exports. Perhaps the most significant immediate

gain for our exporters would be the removal of discriminations against American goods in Canadian, French, and Spanish markets. Nor do I think that American consumers would derive large immediate gains from the entry at lower rates of foreign goods.

But the indirect gain might be far greater. I am thinking about the effect on world tariffs of the American action. The attitude of the United States, I am convinced, has more effect on European and on world tariff policies than our own Congress has ever suspected. In 1928 and 1929 the news that an upward revision of the American tariff was impending was responsible to no small extent for checking the movement in Europe toward tariff reduction. A decisive move now by the United States toward lower tariffs might be the force needed to break the world's tariff jam. It would certainly strengthen the hands of those who the world over are working for the reduction of trade barriers and the removal of restrictions. To put strings on our action, to make reduction dependent on bargaining, would seem to lessen its moral force. Possibly so. But a more than compensating gain, in my opinion, is that bargaining if at all successful will set in motion a series of concessions which through treaty relations must be generalized and thus to the moral force of the American action is added the force of international obligations.

DISCUSSION

Ernest Minor Patterson.—Mr. Wright has summed up his argument in his closing paragraph: "The nations of the world have engaged themselves by a solemn pledge not to use war as a means of settling international disputes. Unrestrained liberty in tariff making tends to make the keeping of this pledge impossible. Tariff making should be subject to international law."

Mr. Bidwell also contends that our tariffs are too high and hunts for an approach toward reduction. He believes that "a decisive move now by the United States toward lower tariffs might be the force needed to break the world's tariff jam." Although he feels that "to make reduction dependent on bargaining would seem to lessen its moral force" there is a more than compensating gain in that "bargaining if at all successful will set in motion a series of concessions which through treaty relations must be generalized and thus to the moral force of the American action is added the force of international obligations."

There are thus certain points in which the two papers agree. Both writers hold (1) that our tariffs are unduly high and (2) that the approach to adjustments downward should be through international action. Mr. Wright argues that tariff making should be subject to international law while Mr. Bidwell favors attempts at bargaining in the hope that a network of international agreements will come into existence, binding the signatories to a reduction in the obstacles to trade.

A possible next step in the discussion is to ask ourselves: (1) will this international approach bring the anticipated results; (2) does not the present position of the United States warrant a reduction of her tariffs regardless of what other countries may or may not do; and (3) in what manner can effective action by Congress be secured?

It is appropriate to stress the value and the practicability of international action. Through it much has been accomplished and doubtless much more will be accomplished in the future. We usually extol its merits by contrasting them with the excesses of economic nationalism. Thus presented the case seems clear but observation of international efforts in recent years suggests that we should not be blind to its limitations.

There are three results and only three that can be secured in this way, whether the approach be through commissions or general conferences or through the ordinary diplomatic machinery. One is that a frank exchange of views often shows a complete harmony of interests that had not before been realized. When this harmony is discovered there is often only slight difficulty in reaching agreement regarding the appropriate action.

A second consequence is that negotiations often make vivid actual differences of interest and confirm the negotiators in their national enthusiasms. And there are actual differences of interest in many matters—not imaginary differences based upon incomplete knowledge of the facts, but real ones. The more information there is available the more vividly the conflict of interest is realized. It is not always to British advantage—either direct or indirect—for the French to withdraw as much gold from Great Britain as

the French find it advantageous to take. Nor can the French with economic gain to themselves import as much British coal as the British would find it worth while to sell in France.

A third consequence of international negotiation is that mutual concessions may be made. The Germans may agree to take more French wine than is advantageous to Germany provided the French will take more German steel than they really care to receive. The gains derived by each in this arrangement may more than offset the losses.

Stated differently, we may say that in much discussion of international questions we are assuming a harmony of interests that is strongly reminiscent of Bastiat and others. The two papers do not commit this error but we may supplement them with a reference to the limitations of what their authors propose. In the field of labor relations we do not insist that employers and employees have interests that in no way conflict. We acknowledge that some of their interests are mutual but proceed on the further assumption that there is a vast area within which their interests differ. In international matters we have a set-up in which the people in each national area have so organized their affairs that in many situations no real harmony can be discovered between the national groups concerned.

This does not mean that the international approach should not be employed but merely that we must not expect too much of it. There are cogent reasons why its limitations are particularly sharp at present. Business is increasingly dynamic. Changes in organization and method, new products and devices—all come with growing rapidity, harassing and perplexing not only the business man but also any outsider who dispassionately observes business problems. Larger-scale production with heavy overhead costs and often with multitudinous by-products, tends to intensify competition. Unstable currencies and exchange dumping furnish still another complication. With these and other influences at work stability is extremely difficult to secure and maintain. We may allege that market stability cannot really be secured through more and more trade restrictions but we need not be surprised if the business man seeks it in every possible way.

If time permitted suggestions could be made regarding several other lines of effort, but we may instead argue briefly that under present conditions the United States can afford to proceed alone. Through bargaining some concessions may be secured but it is very doubtful. Negotiations will be very prolonged and may yield little but disappointment.

The position of the United States is a peculiarly difficult one. From 1914 to 1920 our relation to the rest of the world was altered. We became creditors suddenly, not slowly through decades with time for gradual adjustments of our economic structure. Before the war we were apparently working out of the mature debtor stage into that of an immature creditor. This meant an economic structure adjusted to an excess of exports. The war placed upon us the burden of increasing our exports but tended to restrict imports. By 1920 we were geared to export still more goods and services but not to import goods and services. Yet we had suddenly become creditors.

Instead of systematically and rapidly adapting ourselves to this new

relationship, we made little or no attempt at adjustment. In fact, the task would have been an appalling one and perhaps impossible of accomplishment. Our procedure was not surprising. We pressed exports, visible and invisible, through both private and public effort while restricting imports in a variety of ways. We checked immigration, thus reducing the volume of immigrants' remittances, continued to develop our own merchant marine, financed our foreign transactions more and more with the aid of domestic bankers and insurance companies, and raised our tariffs in 1921, in 1922, in 1930, and in riders to the Revenue Act of 1932. All this was possible because of our willingness to accept a large amount of foreign promises to pay.

By 1932 we have made no appreciable progress toward adjustment. One procedure is that proposed by the advocates of economic self-sufficiency—of "autarchy" as the Europeans are calling it. This will probably be only a passing vogue since world economic currents are so strong. The other procedure is to attempt a freer receipt of imports, notably by a modification of our tariff schedules. The situation is so acute that this should be done even if no concessions can be secured from other countries.

Two comments about it should be made. One is that there is no such thing as adjusting ourselves without some loss. A lowering of tariffs may mean losses to many American producers who rely chiefly on the domestic market and who will suffer from an increase in the imports of competing goods. Yet maintenance of trade barriers curtails the foreign markets for many producers who rely on exports and who have little or nothing to fear from competing imports. To such an extent is this true and so great are its ramifications that the aggregate result of lowered schedules would be a stimulus rather than a blow to most lines of business. Also trade barriers reduce the payments from abroad to the American investors in foreign securities, and their reduction would make possible greater remittances on account of interest and principal.

It is not a question of preventing losses but of deciding (if a calculated decision is really possible) how to minimize the losses. Nor, may we say in passing, is the argument entirely one-sided, as many doctrinaire free traders seem to think. It is interesting to notice that many of our most enthusiastic advocates of national economic planning seem anxious not to plan the ebb and flow of goods and services in foreign trade. Apparently they are planning not to plan at all in this field—or perhaps leave it to the people and governments of other countries.

If we assume that we desire to adjust ourselves to our creditor position and to concentrate at least some of the loss on certain producers for the domestic market by lowering tariffs, what procedure should be followed? Two suggestions may be made.

The first is that we shall probably not get very far by talking in broad terms about the general advantage. Certainly we shall accomplish little if our appeal is to the "public" or to the consumers or to other groups real or fanciful whose interests may be suffering at present. Nor is there any hope of support from geographical regions such as the West or the South, since so many of their industries are now protected.

Instead an appeal may more effectively be addressed to certain economic groups which are not located in any special section of the country but are scattered through all sections. There are three important groups. One is made up of those who produce primarily for the domestic market and are interested in articles that may quickly suffer from imported merchandise if certain tariff schedules are reduced. Even they would gain a great deal from the stimulus to general business which will follow a loosening of trade restrictions, but this is not always easy to appreciate in advance and this group will probably oppose reductions and even press for higher duties.

Those who are producing more and more for export are a second group, while investors in foreign securities are a third. These two are increasingly conscious that they cannot be paid unless their debtors can find dollars and that dollars can be found only if trade barriers are modified. There are already signs of organized effort among them, with a view to securing further reduction of the war debts and lowered tariffs.

A second comment is in the form of a warning. High tariff advocates regularly challenge their opponents to indicate particular commodities or industries now protected that do not need such help. This is, of course, not possible except in rare cases. Where protection has been granted the industry concerned adjusts itself to the assistance given and its withdrawal is at least an immediate disadvantage. The approach must not be by questioning particular rates of duty but by examining the whole policy—by a general rather than by a specific attack.

E. Grosvenor Plowman.—Dr. Phillip G. Wright's paper summarizes the need for control of international economic warfare. He makes the point that the renunciation of war has uncovered the problem of economic warfare. He states that economic warfare between the nations can be as destructive as physical warfare. This suggests a basic principle, that, if we renounce a weapon of great force such as physical warfare, we may expect human ingenuity to devise ways of increasing the destructiveness of lower powered weapons such as economic warfare. We have seen this principle work out in the field of warfare as well, for instance, in the development of the German "pocket" cruisers caused by their forced renunciation of the battleship.

Within the United States, physical warfare has long since been renounced. Furthermore, we have also renounced tariff warfare between the states and between the United States and certain other countries and areas, such as Porto Rico, Cuba, and the Philippines. This renunciation, not only of physical warfare but also of tariff warfare, has resulted in the transfer, through the process suggested above, of force and destructiveness to such weapons as boycotts and campaigns of prejudice. We have seen illustrations of this in the prolonged warfare between beet and cane sugar and between domestic butter and oleomargarine made from tropical oils.

It is, therefore, pertinent to remark that the development of Dr. Wright's proposal to eliminate the use of tariffs in economic warfare through some form of international control and development is likely to result in intensifying economic warfare between the countries through the next lower grade

of weapons such as boycotts and campaigns of prejudice. Dr. Wright's proposal is simply another step in a long series of steps which must be taken to substitute negotiation for warfare.

Francis Tyson.—May I raise a question about the optimistic sentiments expressed by Professor James Harvey Rogers yesterday and by Professor Bidwell this morning concerning the likelihood of any easy congressional acceptance of lower tariff schedules in the near future? Is their commendable viewpoint not a bit unrealistic politically? Despite the great technical difficulties, workable formulae of international reciprocal agreement, looking toward recovery through lowered trade barriers, may be developed; but the prospect of their acceptance, it seems to me, is none too bright.

Let me reiterate Professor Bidwell's point about the fact that no general reduction of the tariff has occurred in our history during a period of general depression. And may I remind you that even those Democratic senators who are enlightened on the economics of the tariff voted for raw material increases recently, as was the case earlier with the Smoot-Hawley bill? These included not only Senator Robinson of Arkansas, the Democratic leader, but also Senator Thomas J. Walsh of Montana, who evidently was hard pressed by the copper interest of his state—a clear-cut reflection of pressure from constituencies "back home." May I point out that the Democratic campaign speeches, with few exceptions, were confused, and not often consistent on the question? Let me call attention particularly to the spread of protectionist sentiment with the new industrial revolution in the South, especially in the textile and iron and steel industries.

I need not remind you of the lack of definite effect of the economists' memorial on the issue; nor should we underestimate the strength of the organized high tariff propaganda in the United States, and the announced intention of influential senators to raise existing schedules farther to limit foreign competition. Senator David A. Reed of Pennsylvania, for instance, has proposed increases in iron and steel schedules, apparently on the basis of the effects of the depreciated currencies abroad. Moreover, only a few leaders of industry, in the fields of motors, electrical equipment, and other export industries, really favor lowered duties. The great majority of industrialists, especially in iron and steel, metals, pottery, glass, and textiles, are antagonistic to downward revision. They do not share the viewpoint of an increasing number of bankers on the subject; the latter, of course, now accept and support the economists' position on tariff revision.

Finally, the lack of preparation of what was called by Professor Bidwell the "public mind" (euphemistically, I presume) on this issue, as in other difficult problems of international relations, is only too evident. The lack of understanding, and the inarticulateness, as well as the weakness of organization, of the American consumer and worker render it practically impossible for the masses to follow their own interest, and to benefit by tariff reduction and international co-operation.

SESSION ON REAL ESTATE SPECULATION

SPECULATION IN SUBURBAN LANDS

By Ernest M. Fisher
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Around the fringes of all urban areas of any size lies the territory into which the distinctly urban uses of land must expand as the community grows. This area has very appropriately been called the "penumbra" of the urban community.[1] It originally consists of lands in distinctly rural uses such as agriculture or forestry. As the circumference of the urban community expands and approaches this land, the uses to which it is put undergo a change. Extensive farming gives way to truck gardening or to golf or other recreational uses. In anticipation of the arrival of the more intensive urban uses, the value of the land increases and taxes mount proportionately. Here and there patches are definitely withdrawn from the rural or semirural uses, platted in small units served by common means of access, and offered for sale as building sites. Frequently the public utilities necessary for urban uses are at least partially installed and completely promised, plans are presented for the development of such community activities as schools and churches, and houses and business premises are built.

These patches of development are widely scattered through the penumbra of the urban area, frequently without relation to one another or to the urban community as a whole. They are isolated nuclei which gradually grow by the process of accretion, absorbing more and more of the penumbra until their borders meet. When the whole of the area has been absorbed into one or the other of the nuclei, it becomes a part of the original urban community.

Thus, the advance of urban uses into the penumbra is by no means a steady or uniform one; the urban uses do not, as might be supposed, creep out into the penumbra at an even pace. They sometimes leap over considerable stretches of territory to establish themselves at spots removed from the fringe of existing uses, leaving the intervening area to be filled in slowly.

There are, then, two distinct phases of the growth of urban uses in the penumbra: one is the expansion stage during which the new nuclei are being established, and the other, the filling-in stage during which the interstices between nuclei are being absorbed. There is little information regarding the length of time which elapses in these phases, but such scant data as have been compiled indicate that it is between fifteen and

[1] See Herbert D. Simpson and John E. Burton, "The Valuation of Vacant Land in Suburban Areas," *Studies in Public Finance,* Institute for Economic Research, Chicago, 1931, p. 2.

thirty years. It probably varies from community to community as the influences affecting the growth of the community vary. In terms of platting and sales activity, the data possess a high degree of periodicity, reaching high points during the period of expansion and dropping abruptly to extremely low points. As absorption of the interstitial areas proceeds, platting and sales activities rise very slowly until another period of expansion arrives. Thus the data reveal marked cyclical characteristics, but the cycles are longer than in the more familiar economic series.

The most pronounced peaks in this activity closely coincide, however, with the peaks in general business activity; and the most abrupt declines in platting activity have occurred at the time of our severest business depressions. For example, platting activity in the Cleveland metropolitan area reached great peaks in 1856, 1873, 1891, 1903, and 1926; it fell to the lowest points in 1861, 1878, 1896, and 1930. Activity in the Chicago area reached previously unprecedented heights in 1837, 1874, 1891,[2] 1910, and 1926.[3] Milwaukee experienced booms in 1837, 1857, 1875, 1892, and 1926;[4] Toledo in 1855, 1874, 1890, 1916, and 1925;[4] Alameda County (San Francisco), California, reached peaks of subdividing activity in 1877, 1891, 1908, and 1925;[5] Detroit's subdividing peaks have come in 1836, 1857, 1873, 1891, 1916, and 1925;[4] those in Grand Rapids, Michigan, in 1857, 1872, 1890, 1906, and 1926.[4] Thus all the major crises since 1850 have been accompanied very closely by peaks and crises in subdividing activity.

It is during a relatively brief period when subdiving activity is reaching its peak that the sorties far into the penumbra are made and the new nuclei established; during the long period of slight activity, the interstices are slowly filled in. The period of explosive expansion precedes or coincides with the rise of general business to a crisis.

This period of expansion has been consistently accompanied by widespread speculation in suburban lands. In the earlier history of the country, speculation in urban and suburban lands centered principally in projected cities laid out, at least on paper, in locations which were "destined to be great emporiums of trade, industry, and commerce."[6] Recently

[2] An interesting description of the boom in Chicago in 1891 and 1892 will be found in H. Morton Bodfish, "Real Estate Activity in Chicago Accompanying the World's Fair of 1893," *Journal of Land and Public Utility Economics*, Vol. IV, No. 4 (November, 1928), p. 405.

[3] These statements are based upon data from an unpublished source.

[4] See Ernest M. Fisher, "Real Estate Subdividing Activity and Population Growth in Nine Urban Areas," *Michigan Business Studies* (1928), Vol. I, No. 9.

[5] See Lewis A. Maverick, "Cycles in Real Estate Activity," *Journal of Land and Public Utility Economics*, Vol. VIII, No. 2 (May, 1932), p. 191.

[6] For a description of some of the speculative ventures in land during the early history of the country, see A. M. Sakolski, *The Great American Land Bubble* (New York, 1932).

something of the same sort of speculation took place in Florida; but for the most part, during the present century and much of the last half of the preceding one, speculation in suburban land has centered in the penumbra of already well established communities.

In these areas speculation takes two distinct forms; the first is speculation in acreage or accommodation land; and the second, in subdivided lots. In both these forms, speculation is difficult to identify with certainty; for as in other types of transactions, the intent of the purchaser is probably the basis of distinction between speculation and investment.[7] Thus in many instances the same individual in the same transaction may be at one time a speculator and at another, an investor. To the extent that the motive in purchasing is gain from the enhancement in value, the transaction is speculative; to the extent that income rather than increment in capital controls, it partakes of the nature of an investment.

As a matter of fact, the purchase of acreage or accommodation land is in most cases almost wholly speculative. In periods of expansive booms, the price at which acreage sells increases with sometimes astonishing rapidity. In such cases, it is easy to interest individuals with considerable wealth in speculating on such increases. The usual procedure is to form syndicates for the purpose of buying tracts of land in the penumbra or taking options on them and holding them for increases in the price which someone will pay for them for the purpose of subdividing. In many cases, acreage "specialists" appear, who make it their principal activity to form such syndicates. Frequently these syndicates sell to each other, always at advancing prices, until a subdivider buys a tract and proceeds to subdivide it.

No data are available as to the extent of such operations or the measure of the increase in the price of land traceable to them. They are, however, very extensive during a boom period, and the increases in price are not infrequently in a single turnover as high as 100 per cent. Usually these transactions are kept quite confidential; the members of a syndicate are usually known only to the broker or specialist who manages the transaction and to each other, and prices paid and received by the syndicates are jealously guarded.

The best that can be said of this type of speculation is that those who engage in it speculate largely with their own money. They usually operate, however, with as little cash as possible, buying on as favorable terms as they can secure, thus being able to realize a large percentage of profit on capital invested. When prices continue to rise, they reap handsome profits; when the rate of expansion declines, they suffer heavy

[7] Cf., Charles O. Hardy, *Risk and Risk Bearing* (Chicago, 1931), p. 127. Also, Lionel D. Edie, "Investment," *Encyclopædia of the Social Sciences*, Vol. VIII, p. 263.

losses. In many instances, however, acreage syndicates have paid as high as 800 per cent on capital actually invested.

Thus, from the point of view of the individual, speculation in acreage is extremely hazardous, but may bring large rewards. It results in very radical redistribution of wealth. When a venture is successful, the profits of speculators come from the pockets of subdividers or members of similar syndicates; and when the venture of these groups proves successful, the profits of the acreage speculator are loaded on to the selling price eventually asked for lots created from the acreage. Losses from unsuccessful ventures, of course, fall principally upon the speculators. From the point of view of society as a whole, there is merely a transfer of wealth; no new wealth is created, and little is lost by these transfers of ownership.

But, notwithstanding this fact, society does suffer from these operations in two distinct ways. First, the land involved is nearly always thrown out of use and lies idle while it is being held by the speculators. This land is usually so situated as to enable it to render valuable services as ordinary farms, truck farms, or recreational land. Instead of receiving the benefits of such services, the community must see this resource lie idle. About the fringes of most large cities today lies a great belt of such idle land, grown up in weeds, delinquent in taxes, and derelict.

Society also suffers from the disruption of economic relations brought about by both the losses and the profits of acreage speculation. In many communities, some of the wealthiest and most prominent leaders upon whom the welfare of the whole community depended have been bankrupted by acreage speculation. Sellers to speculators have been disappointed in failing to receive expected and contractual incomes and have in turn been compelled to default upon obligations they had undertaken. Thus the economic relations in the entire community have suffered.

It is difficult to discover any economic function which this kind of speculation performs. It cannot be defended on the same grounds as can speculation in the usual forms. It does not serve as a regulator of the market, and but partially to transfer risk to a professional class of risk bearers.[8] In fact, much of the risk involved is actually created by the speculators. In a sense, therefore, it is more nearly comparable to gambling than to the usual forms of speculation.[9] There appears to

[8] Cf., Allan H. Willett, "The Economic Theory of Risk and Insurance," Columbia *Studies in History, Economics and Public Law* (New York, 1901), Vol. XIV, No. 2, p. 134. Also Charles O. Hardy, *Risk and Risk Bearing* (Chicago, 1931), Chaps. IV, VII, and IX.

[9] The owner of acreage, of course, has to carry some risk of a decline in price. But he is presumably utilizing the land until acreage speculation begins. His risk, therefore, lies in the possibility that he may not sell at as high a price to a subdivider as he can secure from acreage speculators. When the latter purchase the acreage, the price they demand is increased, the land is thrown out of a productive use, and the whole price they pay is based upon a speculative hope for further ad-

be no necessity for the intervention of acreage speculators between original owners and subdividers. They insinuate themselves into the situation and sit and wait for profits. When profits are realized, they are paid for their risk by higher prices that final users of the land must pay. If any economic function can be claimed for them, it consists of the very feeble one of assembling larger tracts than might otherwise be available. On the whole, therefore, this type of speculation in suburban land is to be condemned as socially undesirable.

The activities of the subdivider are of two distinct types: in the first place, he may be compared to a manufacturer whose raw material is acreage and whose finished product is the urban site ready for use; in the second place, he is a merchant who must sell his wares to the general public. The degree of risk involved in these activities depends very largely upon his methods of operation. In practice, two distinct methods are found. These methods suggest the classification of subdividers into two groups, one of which subdivides primarily to supply a need for new and additional building sites, the other for a market in which the new sites can be sold not for use but for speculation (called "investment"). The one who subdivides for use finds his market among those who propose to build a house or a business building promptly; the one who subdivides for a market sells to everyone who can be persuaded to speculate.

Some of the most notable achievements in community planning and building of recent decades have been accomplished by subdividers who were attempting to supply a need. Among these achievements the Country Club District of Kansas City, built by J. C. Nichols, and Roland Park, Baltimore, may be mentioned. This type of operation does involve risk, but in it risk is reduced to a minimum. The greatest hazard it encounters is that created by the speculative operator who floods the market and paves the way for a subsequent collapse.

It is this second type of operation that tends to enhance the risk involved; and to the degree that risk is magnified, the subdividing process becomes speculative for all operators. Thus under present methods of operation, the whole process is shot through with uncertainty and unnecessary risk. As a result, the profits from successful operations are swollen and the losses sustained from unsuccessful ventures are disastrous. The whole process needs, both from the operators' and the public's point of view, a thorough revision of practices and methods. The only purpose of subdividing activities, one would suppose, is to provide additional urban sites for use as the urban community grows and needs more space. The need for sites, in other words, would appear to

vance; thus the risk is enhanced. They stand to lose all their investment; the owner only to lose the margin between the value of his property for current uses and for speculative purposes.

be the criterion by which the extent of subdividing activity should be gauged, just as the manufacture of automobiles or shoes or any other commodity should be gauged by the most intelligent analysis possible of the need for the commodity produced. But the wider one's observation, the more certain is bound to be his conclusion that need for urban sites for use is never the controlling consideration with most subdividers and is, in many cases, not even considered. This fact accounts for the spectacular rises in the activity of the market and for its subsequent collapse and paralysis. The length of the cycles may be partially accounted for by the fact that it takes nearly thirty years to produce a new generation, which has to learn by pain and disappointment that while many fortunes may have been made through investments in real estate, many paupers likewise have arrived at their destination by the same route.

As a matter of fact, in most urban communities, the number of subdivided lots is nearly twice as great as the number in use; that is, for every lot in use, there is another lot vacant. In the Grand Rapids, Michigan, metropolitan area in 1931, 51,000 lots were in use and 40,000 vacant.[10] The percentage of lots vacant has varied since 1909 from 38 to 45. In terms of population, there were 43 subdivided lots of record, per hundred inhabitants, and 24 per hundred in use. In Chicago, in 1928, there were 1,227,000 lots of record and only 668,000 in use.[11] In Detroit, in 1926, there were about 25 per hundred in use and 75 per hundred of record. In Cleveland, in 1926, there were 30 lots of record per hundred population, and probably not more than 20 per hundred in use. In Milwaukee, in 1927, there were 36 lots of record per hundred population, and probably not more than 23 per hundred in use. Finally, in Birmingham, Alabama, in 1927, there were 44 lots of record per hundred population, with probably 25 in use.

It may be assumed that the principal source of the need for new lots is population increase, but when the total number of lots subdivided in any large urban community between 1920 and 1930 is expressed in terms of increase in population during the decade, the absurd heights to which speculation led subdividers becomes apparent. Thus, in the Detroit area, from 1920 to 1930, the increase in population was 843,586, or 70 per cent; in lots subdivided, 622,493, or 100 per cent; or for every one hundred newcomers to Detroit about 74 lots were prepared. In Cleveland, from 1920 to 1930, over 112,000 lots were platted, an increase of 43 per cent. Population increased by 258,000, or 28 per cent; platting activity, therefore, added 43 new lots for every increase of one hundred persons. In the Chicago area, population increased from 1920 to 1928 by about 700,000, or 26 per cent; lots platted increased from

[10] Ernest M. Fisher and Raymond F. Smith, "Land Subdividing and the Rate of Utilization," *Michigan Business Studies*, Vol. IV, No. 5.

[11] Simpson and Burton, *op. cit.*, p. 14.

1920 to 1926 by 448,000, or 34 per cent; and 64 new lots were available for every one hundred new inhabitants. In Grand Rapids, during the decade 1920 to 1930, the number of lots increased by over 34,000, or 60 per cent, while population was gaining 52,000, or 33 per cent; and 65 new lots were available for every one hundred newcomers. But, actually, one hundred newcomers to Grand Rapids during the decade used, on the average, only 24 lots. If utilization proceeded in Grand Rapids at the unprecedentedly rapid pace established during the decade, it would be over twenty years before the present lots were used; and if utilization proceeds at the same pace at which it has proceeded since 1909, some thirty-five years will be required to bring the lots into use. Professor Simpson estimates[12] that even by 1960, population growth will have required the utilization of only 90 per cent of the lots now available in the Chicago area. In short, subdividing anticipates utilization by some thirty years, and the speculative subdivider sells his product for speculation. This fact makes his business exceedingly hazardous. For when the speculative frenzy dies, it takes a generation for the market to "come back."

The process by which sales are made is too familiar to need description. It is one in which high pressure salesmanship, cheap ballyhoo, and extravagant claims all play their part.[13] The psychological characteristics of the market are typical of all speculative markets. The questions of use and value are entirely forgotten, and prospective purchasers are frequently "guaranteed" by glib and conscienceless salesmen that they can resell their properties within a few weeks, or months at most, at advances in price. Elaborate sales arguments are built up around statistics of city growth and especially the increases in value that have come to strategically located business sites. The inference is that all urban land increases in value and the purchaser has only to wait until the inside residential lot, remote though it may be from transportation and other factors that might enhance its value, and although it is one in hundreds that are almost identical to it, will also sell for thousands when he has paid only hundreds.

In blind obedience to the speculative impulse, literally thousands of the middle classes and of the laboring classes succumb to these arguments and purchase. Thus in nearly every urban community, between 1920 and 1926, thousands of these classes bought lots, paid 10 per cent down, and mortgaged their earnings for about ten years to pay the

[12] Herbert D. Simpson and John E. Burton, "The Valuation of Vacant Land in Suburban Areas," Institute for Economic Research, *Studies in Public Finance*, Research Monograph No. 2 (Chicago, 1931), p. 20 ff.

[13] For a description of some of the more reprehensible practices see H. Morton Bodfish, "The Free Lot Subdivider: His Method of Operation and the Available Methods of Control," *Journal of Land and Public Utility Economics*, Vol. V, No. 2 (May, 1929), p. 187.

"deferred balance" with interest and taxes. In one case, which may be taken as typical, over 75 per cent of the residential lots in a large subdivision were sold to people who were not even residents of the county in which the subdivision lay. Residential lots in the suburban area of Detroit were then sold in all the states in the Great Lakes region, and as far south as Georgia. Washerwomen and Ford factory workers, school teachers and professional men were all proud to be counted as owners of Detroit real estate. Likewise, suburban lots in Chicago were sold throughout the Middle West, and those cities which were not exploited so widely enjoyed a big domestic boom in which nearly every family in their borders staked its hopes of prosperity and fortune upon vacant lots. And even as late as 1931, it was reliably reported that in a community of 30,000, a suburb of Detroit, over $100,000 worth of vacant lots in Windsor, Canada, across the river from Detroit, were sold in less than three months.

As soon as the speculative subdivider has secured contracts for the purchase of the major portion of the lots in a subdivision, he purchases another piece of acreage, and repeats the process of platting and selling. He thus places himself in the remarkable position of openly competing with his own customers. He has the advantage of his customers, however, in two ways. First, he dominates the market. His salesmen and his advertising seek out every potential buyer of a vacant lot. They call upon builders, they canvass all the names in the telephone books and even ring doorbells so as to make their canvass complete. It is, thus, by almost a miracle that any purchaser in a previous subdivision finds a bona fide purchaser for his lot that was so "sure to increase in value." But so long as the big subdivision across the street or farther down the road is selling out, even at advanced prices, he is not likely to get restive. He has comparatively little invested as yet anyhow. But all the time he is paying on his land contract to the subdivider. Thus we find the second advantage of the subdivider in the speculative market: he not only competes with his own purchasers, but he actually gets them to finance his speculative competition.

But eventually something happens. The market becomes surfeited; a catastrophe visits the community or the whole nation; the speculative fever subsides; purchasers for profit become more and more restive and anxious to realize their profits; and the market collapses. With it the whole structure of credit involved in the operations becomes undermined and falls. Then usually the subdivider is trapped as well as his customers. For he has proceeded to larger and larger operations on narrower and narrower margins. His collections on early contracts fall off and he becomes unable to meet maturing obligations. Thousands of the unsubstantial and "fly-by-night" operators, who consistently follow

the speculative market from city to city and from state to state, disappear. Lots by the thousands are offered for the balance due on the contract, and there are no takers. Taxes, in the meantime, have risen to meet the costs of governing the vast stretches which have been "annexed" to cities and municipalities, and tax delinquencies appear. In some communities, land contracts have been used as collateral to bond issues that were sold to the public. Over 60 per cent of such issues in one large city area have defaulted, while tax delinquencies have occurred on as much as 47 per cent of the entire area of one of the municipalities in the vicinity of one of our largest cities. The savings of the thousands who speculated have thus been wiped out. Capital expended in the installation of streets, sidewalks, and public utilities lies idle and is rapidly disappearing, while only the miles of decaying sidewalks and reeling lamp posts remain to bear mute testimony to the speculative folly of both subdivider and "investor."

The social losses involved in this process arise from several sources; the first is the loss of the services of the land; second, the loss of the time and labor of the subdivider and his whole crew; third, the loss of capital invested in "improvements" which will either yield a very insignificant return of services to scattered or isolated families or will entirely disappear; and fourth, the losses due to dislocation of economic relations in the community. No quantitative measure of these losses is available. It may be assumed, however, that they are probably not less than the amount invested in vacant lots. This amount has been estimated in two communities. A very conservative estimate for the city of Grand Rapids places the amount at $26,000,000, enough to pay the entire tax bill of the community for over three years, or to pay off all the bonded indebtedness of all governmental units in the area with more than $5,000,000 left over. It represents over $150 per inhabitant of the metropolitan area in 1930. And it should be added that Grand Rapids is by no means a "horrible example." The situation there probably represents rather the typical than the worst in the country. In Los Angeles, Riggelman and Eberle estimated in 1924 that 156,557 lots were vacant. The estimated value of these lots, based upon an adjustment of assessed valuations, was $1,100,000,000. They further estimate the annual cost of carrying these lots at $100,000,000.[14]

It is obvious that any such drain upon the financial resources of a community as is indicated in these communities represents the diversion of a significant amount of capital to a nonproductive purpose. This diversion in turn probably affects the interest rates which productive enterprises must pay. The result may be an interest rate so high as to prove a handicap to industry and production in general.

[14] See Riggleman and Frisbee, *Business Statistics* (New York, 1932), pp. 489, 491.

In one instance a city was obliged to spend over $19,000,000 in constructing a sanitary sewer to serve outlying subdivisions, sparsely settled, and scattered over a wide area. This was probably at least twice the sum that would have been necessary to serve the same number of people if they had been located more closely together. Similar wastes occur in connection with the provision of miles on miles of water mains, sidewalks, and pavements for isolated units.

In many respects, however, the heaviest loss to the community comes from the disruption of economic relations. The influence of subdivision activities on the general credit situation in a community is both far-reaching and profound. When the market and values upon which credit is based collapse, the repercussion must be severely felt upon the whole economic life of the community. Further, the wide distribution of losses causes them to fall, in probably a majority of cases, upon those who are least able to bear them. It is the laborer and the skilled artisan, the widow, and the white-collared class who suffer most in these fiascos. They are told that land is the safest form of investment, that it cannot be destroyed, stolen, or moved away, and that it always enhances in value. Since the majority of these classes are uninformed of the facts in the situation, they are easily imposed upon. The resulting losses to them and to the community because of the disruption of economic relationships would be difficult to exaggerate. That the whole process plays an important part in the business and economic welfare of the community appears to need no argument.

In view of this fact, it may be desirable to examine some of the proposals for social control that would tend to curb the excesses and secure a better adjustment of subdividing activities to the needs of the community for additional urban sites.

The most direct method of control would consist of public purchase and ownership of the acreage in the penumbra. This method has been successfully used in Stockholm, Berlin, Cologne, Frankfurt on the Main, and other German cities. It gives the municipality or other public body practically absolute control when ownership is extended to enough of the land in the penumbra to give the public authority a virtual monopoly of acreage. When ownership is coupled with the use of such an instrument of tenure as the long-term lease, the control is perpetuated. This method of control, however, is foreign to American custom, political and legal thought. It is difficult to imagine its ever being widely authorized or adopted.

The second method of control suggested consists of enacting legislation which is based upon the assumption that subdividing activities are vested with a public interest and which will require those who propose to subdivide to secure from a public administrative body a certificate of public convenience and necessity before proceeding.[15] Much of the

data necessary to enable such a body to adminster this sort of law effectively and fairly is available. In city planning commissions and other similar administrative authorities the machinery for administration is provided. The attitude of many of the higher courts expressed in decisions in city planning and zoning cases indicates that these courts might be friendly toward such legislation if conservatively drawn and intelligently and tactfully defended before the courts. But there are many problems of both economics and law that have to be carefully examined before such legislation could be properly drawn. It is doubtful also whether state legislatures would be friendly toward so radical a departure. The present, however, is an exceedingly favorable time to present such a proposal. It remains to be seen whether any such legislation will be prepared.

These two proposals are aimed directly at the heart of the problem; namely, control of the quantity of land subdivided. Some other proposals designed to modify the situation somewhat have been made. Among these are: (1) The proposal that subdividers be required to install the necessary public improvements in all plats subdivided, or to post a bond guaranteeing such installation, before the lots are offered for sale to the public. This proposal is intended to eliminate the irresponsible and fraudulent operator who promises everything and delivers only staked lots. (2) The proposal that before a subdivider be permitted to offer lots for sale, he must prove ownership of the property free and clear, or he must be joined in all contracts for deed by parties who have any prior liens or interests in the property. This proposal has the same intent as the previous one, and, in addition, the intent of preventing contract purchasers from losing their equities by default of the subdivider on underlying obligations.

Something certainly could be accomplished by the collection and dissemination of information regarding the situation as it exists in various communities. Such data as have been collected have demonstrated that discrepancies between the total number of sites subdivided and the needs due to population growth can be discerned early in the boom period. If these data could be interpreted to the public as a whole, they would doubtless serve to temper the enthusiasm of speculative buyers. The difficulty in the use of this method lies in the problem of getting the material before the public and sufficiently interpreting it to enable them to discount the representations of sales agents.

That some form of social control is desirable does not need to be argued. It is fervently to be hoped that the last of the great waves of speculation in suburban lands may have been seen.

[22] See Coleman Woodbury, "Some Suggested Changes in the Control of Urban Land Development," *Journal of Public Utility Economics,* Vol. V, No. 3 (August, 1929).

REAL ESTATE SPECULATION AND THE DEPRESSION

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A wise prophet observed many years ago that "when the blind lead the blind, both fall into the ditch"—a maxim which accurately describes our situation in both business and government today. In this respect the real estate field is no exception, unless it be in the extent of its mishaps and the number of people affected by them. It behooves us, therefore, to give some serious thought to the manner in which we have arrived in our present unhappy situation.

This situation, to tell the truth, is not entirely a novel one. The economic history of this country is colorful with recurring speculative epochs and episodes, growing out of varying conditions and with varying effects upon our economic structure and welfare. We have had periods of gigantic speculation in western lands; periods of oil and mining speculation; periods of bank speculation; and of railroad speculation. In the past fifteen years we have had two distinct speculative movements of huge magnitude: the agricultural boom and collapse in the period 1916-21, and the urban boom and collapse in the period 1921-30, interspersed with the Florida episode and other outbreaks of organized crime in various parts of the country.

Our latest speculative movement differs from all previous speculative eras in the United States in the fact that it has been distinctly an urban field of speculation, based primarily upon one specific phenomenon; namely, the growth of urban population and wealth. The rural sections of the country have been in a state of depression throughout most of this period, and the very cities in which active real estate speculation has been carried on have been surrounded by rural populations in acute distress. The agricultural depression in reality contributed substantially to the urban inflation by forcing the movement of millions of people from the farms and small towns to swell the population of the larger cities. Furthermore the low prices of agricultural products increased the margins of real wages and profits in urban industries and resulted in the shift of a larger segment of the national income from rural to urban centers. In short, the agricultural depression had the effect of shifting population, income, and wealth to the cities, in addition to the numerous other factors contributing to the urban growth of this period. Altogether the urban population of the United States increased fourteen and a half million in the decade 1920-30. This spectacular growth of urban population and wealth provided the basis for a period of sensational real estate speculation.

The extent of this urban speculation Professor Fisher has indicated. I may contribute one further illustration. In Cook County, outside of Chicago, we had, in 1928, 151,000 improved lots and 335,000 vacant. On the basis of our Regional Plan Commission's estimates of future poplation increase, it will take until 1960 to absorb the vacant lots already subdivided in 1928. In fact, on the basis of these computations, we shall still have 25,000 of these vacant lots for sale in the summer of 1960. In one township, Niles Township, we have a population of 9,000, and enough vacant lots for a population of 190,000.

But the facts are sufficiently well known; and throughout the remainder of this paper we will confine our comment to (a) the results of this speculation, (b) the conditions which led to its excesses, and (c) the possible means of preventing its repetition.

What has been the impact of all this upon our business and financial organization?

Its first impact has fallen upon the very heart of our financial organization; namely, the banks and financial institutions. We have no fully developed system of real estate mortgage banking, under legal auspices and supervision, and that is a part of the story; but all the financial resources of existing banking and financial institutions were utilized to the full in financing this speculative movement. The insurance companies bought what were considered the choicer mortgages; conservative banks loaned freely on real estate mortgages; and less conservative banks and financial houses loaned on almost everything else that represented real estate in any form.

A particularly ominous development was the expansion of the banking system itself for the specific purpose of financing real estate promotion and development. Real estate interests dominated the policies of many banks, and thousands of new banks were organized and chartered for the specific purpose of providing the credit facilities for proposed real estate promotions. The greater proportion of these were state banks and trust companies, many of them located in the outlying sections of the larger cities or in suburban regions not fully occupied by older and more established banking institutions. In the extent to which their deposits and resources were devoted to the exploitation of real estate promotions being carried on by controlling or associated interests, these banks commonly stopped short of nothing but the criminal law—and sometimes not short of that.

In addition to this dangerous alliance of banking and real estate promotion, a third and more ulterior element was often included in the combination, that of local government officials and political groups. The purpose of this combination was sometimes to facilitate securing a charter, sometimes to secure the deposit of public funds, at other

times to insure favorable treatment in tax matters and to exploit the projection of streets and highways and other public improvements. A fourth element frequently found in these banking institutions was represented by the contractors' and construction groups, whose interests are obvious; and a fifth element was frequently made up of local public utility interests, who were able to combine the extension of surface and rapid transit lines with large real estate promotions.

Now, when it is recalled that these were not mortgage banks, organized on principles of long-term financing, investing their own capital funds, and free from deposit liabilities, but that they ordinarily purported to be commercial banks, engaged in accumulating and carrying large deposits, and that their operations were financed largely through the funds of their depositors, it will be realized in what a highly overextended position this segment of our banking system was placed.

Eventually we reached a point where most of the city and outlying banks of the country were loaded with real estate loans or real estate liabilities of some sort. Not all of these loans were speculative; many of them were intrinsically sound and conservative. But a large, probably a major, portion of this loan structure depended for its solvency upon a continuation of the rate of absorption and turnover which had characterized the real estate market, and on a continued advance of real estate values. When the rate of absorption halted and the price movement stopped, one of the largest categories of bank collateral in the country went stale, and the banks found themselves loaded with frozen assets, which we have been trying ever since to thaw out.

It will be conceded that our knowledge of the amount, proportions, and character of real estate liabilities carried by all the banks of the country in 1929 is far from exact. We do not have all the facts and figures, and in the nature of things probably will never have them. But it would seem that we can safely say this much: that real estate, real estate securities, and real estate affiliations in some form have been the largest single factor in the failure of the 4,800 banks that have closed their doors during the past three years and in the "frozen" condition of a large proportion of the banks whose doors are still open; and that as the facts of our banking history of the past three years come to light more and more, it becomes increasingly apparent that our banking collapse during the present depression has been largely a real estate collapse.

Throughout this period there was another form of real estate speculation, not commonly classified as such, but one that has had disastrous consequences. This was the real estate "speculation" carried on by municipal governments, in the sense of basing approximately 80 per cent of their revenues upon real estate and then proceeding to erect a struc-

ture of public expenditure and public debt whose security depended largely on a continuance of the rate of profits and appreciation that had characterized the period from 1922-29.

During this period of prosperity real estate taxes were paid with little complaint. As a matter of fact, they were paid to a large extent neither out of capital nor earnings, but out of increment. Under these conditions, public expenditures expanded and taxes were increased without protest; and public officials exploited the real estate groups as systematically and thoroughly as the real estate groups had exploited the rest of the public. The result was a structure of public expenditure which it has been difficult to curtail, and a volume of indebtedness whose solvency is now seriously jeopardized on a large scale.

The most conspicuous example of wholesale governmental speculation in real estate was that of Florida; but striking examples of the same thing are afforded by the financial difficulties of Chicago and other cities. In Chicago, it is true, there were some special circumstances; there are always special circumstances in the neighborhood of a shaky structure. But the essential elements in our financial difficulties in Chicago are an extreme concentration of tax burdens on real estate and a volume of expenditure and indebtedness which assumed a continuation of real estate profits and appreciation. Hundreds of other cities and local governments in the United States are now in default or on the verge of insolvency for substantially the same reasons. The impairment or collapse of their finances and credit has seriously impaired the credit situation in their various communities.

The final impact of deflation and loss in any field of industry falls upon the purchasing power of the individuals and groups directly and indirectly dependent upon this industry; and so the final impact of the successive inflation and deflation of real estate has fallen upon the individual owners of real estate. In this case, it has somewhat special significance on account of the wide distribution of real estate ownership. Indeed, one of the results of the speculative activity itself was to broaden the distribution of real estate ownership in this country. The wide distribution of losses meant a violent contraction of established purchasing habits, with disastrous results in retail and wholesale commercial channels.

In consequence of these various impacts of the real estate inflation and deflation we find ourselves in a depression, in which, while real estate is only one among many factors, it is nevertheless a major factor, and one whose ramifications and influence in the situation assume larger proportions, as the underlying facts of the depression come more and more to light. And the writer hazards the conjecture that when the history of the past decade is finally written in economic terms, it will be

apparent that our spectacular urban expansion, with the reckless speculation based upon it, has been one of the dominant aspects of the whole somewhat bizarre period.

And while speaking of the character of this speculation it will not be amiss to offer some comment upon the factors which contributed to its excesses and its ulterior aspects.

One of these is the fact that much of the real estate business of the past few years has been more a merchandising business than a field of speculation; and it is a mistake to confuse the two things. It is the writer's conviction that the unfortunate conditions in the real estate field today are due quite as much to vicious merchandising methods as to unwise speculation.

Real estate merchandising performs certain highly useful services, analogous to the functions of the middleman in other fields. But there are certain fields of merchandising which, on account of the nature of the commodity handled, the character of those engaged in it, or other circumstances, have developed particularly vicious methods of merchandising. One of these, for example, is the field of patent medicines and medical quackery; and another is real estate. In both fields the explanation lies, in part, in the nature of the commodity. No one knows but that a certain combination of roots and rattlesnake oil may happen to contain the particular ingredient that will relieve his pain; and no one knows but that a particular lot out in the sticks may happen to be the center of a future suburb.

In both fields, the explanation lies in part also in the nature of the clientele appealed to. The medical fakir appeals to the large body of suffering humanity in need of relief; the real estate fakir appeals with shrewd salesman's instinct to those large classes who cannot anticipate financial security unless through the medium of some fortunate investment of the small surplus they can command. This is illustrated by the wholesale victimizing of teachers, preachers, salaried people, women, and people of small means in general.

And in both fields the explanation lies, further, in the character of those who engage in them. I have known medical quacks, and at the present time I have the honor of including some real estate quacks among my personal acquaintances. Of the two, the real estate fakir is the more unscrupulous type, quite frequently the racketeering, crooked-politician type. If anyone is inclined to think this overdrawn, concrete evidence of it is afforded by the notorious extent to which successful racketeers have gone into real estate, as a field of respectable business into which they can graduate with the least readjustment of previous business habits.

The truth is that much of the real estate activity of the past few

years has been as devoid of speculation as anything could be, so far as the promoters and operators were concerned. The operator who drove his stakes in the swamp and moved his electric light posts from one temporary subdivision to another had no intention of speculating—at least not in his own properties. He was merely a peddler, relying on highly developed merchandising methods to dispose of his wares quickly and move on to the next countryside. Many real estate and building promotions did not represent even devices for selling real estate primarily, but for merchandising various types of securities, for selling materials and equipment, for marketing contractors' supplies and services, and for still more remote emoluments.

To call this "speculation" and ascribe its unhappy results merely to "excessive speculation" is applying a conventional terminology to a situation which it no longer describes. When a real estate concern, a reputable bank, and the city officials of a local municipality all conspire together to have a large order of sewer pipe (intended for the regular city streets) hauled out and spilled along the streets of a new subdivision, left there over the week-end to give an appearance of immediate activity, and then gathered up by the city trucks and hauled back to its original destination—that is not real estate speculation. And when the bank subsequently finds itself loaded with "frozen assets," to ascribe its difficulties merely to "excessive speculation" is a misplaced euphemism. The writer has thus far felt obliged to use the conventional terminology, but takes this occasion to point out that much that was called speculation in the period we are discussing was actually something very remote from speculation.

In the second place, the real estate business has for years been conducted in more complete detachment from any relation to the facts that underlie it than any major line of business or industry of which the writer has knowledge. Much of it has had no discoverable relation to facts. Yet facts of the type to which Professor Fisher has referred and scores of other equally pertinent and concrete facts could have been known at the time that policies were being determined, if real estate operators had cared for facts or cared to base their policies on them. Their refusal to ascertain or to face the facts was one of the factors that made collapse inevitable.

The more important question now is whether anything can be done to prevent a recurrence of this whole episode in our next period of prosperity; or shall we, like the popular character in the play, merely make the most of the depression while it lasts, resigned to the prospect of an inevitable return of prosperity, when we shall have the whole thing to go through again?

In the first place, it may be observed that there is nothing in all this

unfortunate development to indicate that there is not still a field for the useful functions of speculation in land and real estate, as in other fields of legitimate speculation. Speculation widens the market, increases the salability and fluidity of real estate, broadens the distribution of property, and frequently provides somewhat specialized resources for carrying the peculiar risks of land ownership and utilization. Especially in a country like the United States with its vast area and resources, its broad movements of population and industry, and its rapidly changing industrial structure, there is need for all the speculative capacity that can be developed for discerning these movements beforehand and providing facilities for their orderly development. And in many periods in our past history courageous and intelligent speculation in land and real estate has played a strategic part in shaping our economic progress.

It is not necessary to go to extremes; we need not feel obliged to justify every form of speculation in land or hunt for far-fetched grounds on which to justify legitimate speculation. We need not agree, for instance, with a writer in the *Atlantic Monthly* a decade ago that had it not been for unrestricted land speculation in the West, the buffalo would still be roaming the Mississippi Valley and chewing their cuds in the outskirts of Chicago. There are subdivisions on the outskirts of Chicago today, which, if they could be utilized for a good "buffalo wallow," would be contributing a higher service than any they are now rendering. And we need not take alarm, with another distinguished American economist, lest the adoption of a tax on site value might make it necessary to repeal the tax on oleomargerine, "imposed primarily to insure the purity of butter." Speaking from the rural background of our own early years, we are too keenly aware that the purity of butter depends on many other things than either taxes or speculation. But while avoiding all such extremes, it is still true that there is an important field for intelligent real estate speculation; and our problem is, if possible, to preserve this field while avoiding the disastrous results of our recent episode. To this end we shall enumerate four general lines of possible action, all of which grow directly out of the facts and conditions already described.

In the field of subdivision development, particularly on the periphery of our larger cities, we have reached an intolerable situation. Subdivision, as it has been practiced in the past, has destroyed thousands of acres of valuable agricultural land and has surrounded our larger cities with a "no-man's land" of devastation and desolation. I am unable to discover any element in the real estate business, as now organized and practiced, that promises to prevent a repetition of past experience as soon as normal times return. I am coming to the conviction reluctantly that we are going to be compelled to subject this field of activity to positive public regulation in the form of requiring a certificate of public neces-

sity and convenience before a new subdivision can be developed, with requirements insuring specified standards of lay-out, transportation facilities, public utility services, and the financial responsibility of the company undertaking the development. The one consideration that would still make me hesitate is the character of our municipal governments, upon whom in most cases this regulative authority would have to be conferred. If our city governments in the next decade, as they have been in the past, are going to be turned over to our "Big Bills" and "Dapper Jimmies" and their numerous associates it is worse than futile to talk of conferring any additional powers upon them. In that case, we are between the Devil and the sea and it is useless to try to choose between them. But if we should be able, by the grace of God, to pull our municipal governments out of the slough of incompetence and corruption into which many of them have fallen, one of their worth-while functions may well be the supervision of their own planning and development.

The collapse of our banking system under the weight of real estate financing was due in part to the inflated character of real estate securities; but it was due in part also to the character of the banking system. We were trying to finance a real estate movement through the agency of a commercial banking system. The results have demonstrated anew the need for a fully developed system of mortgage banking, subject to the same type of control and supervision as our national bank system. Feeble and somewhat muddled steps have been taken in that direction in the form of the Federal Land Banks, Joint Stock Land Banks, and our Home Loan Banks; but certainly our experience in the field of real estate financing for the past decade demonstrates the urgent need for a fully developed system of mortgage banking under government control and supervision.

The financial difficulties of local governments in consequence of both the inflation and deflation of real estate values demonstrates strikingly the unwisdom of a revenue system concentrated so heavily upon real estate, or upon any other one commodity. A tax system that rested on a broader base, that drew its revenues from a greater number of categories of tax-paying ability, would have weathered the period of adversity with less wreckage to itself and less demoralizing effects on private credit and investment.

In the fourth place, something can be accomplished by the concentration of more scientific study upon the field of urban economics. When speculation dealt with western lands, oil and mining exploitation, railroad promotion, and similar fields, there may have been little field for scientific study. Fortunately the urban field of real estate speculation is one in which there are wide areas capable of scientific exploration.

Such problems as population trends, influence of the agricultural situation, geographical movements of industry, population densities, absorption rates, housing and residential trends, building height and traffic problems, obsolescence, taxes and special assessments, and influence of public improvements on land values are all capable of scientific exploration. And while in none of these fields will the facts alone afford an answer, a real estate business based on recognition of these facts will be a very different thing from most of the real estate business of the past decade.

Now, none of these things, nor all of them put together, will prevent speculative excesses from time to time. But if during the past decade we had had even a half-way intelligent public regulation of subdivision development, if we had had a fully developed system of mortgage banks under legal supervision, if we had had a tax system that rested to a substantial extent upon other categories of ability than real estate exclusively, and if we had had more intensive research and a wider dissemination of the facts affecting urban growth, it is safe to say that one of the major factors in the present depression would have been considerably minimized.

MINUTES OF THE BUSINESS MEETINGS OF THE AMERICAN ECONOMIC ASSOCIATION, HELD IN CINCINNATI, OHIO, DECEMBER 28-30, 1932

The first business meeting of the American Economic Association was held at 9:00 A.M., December 29, 1932, in the Netherland Plaza Hotel, Cincinnati, Ohio, with President Barnett presiding.

The minutes of the meeting of December 30, 1931, were approved as printed in the *Proceedings of the Forty-fourth Annual Meeting*, pp. 277-279.

The following reports were read and approved:

(1) The Secretary, Mr. Deibler. (See p. 176.)

(2) The Treasurer, Mr. Deibler. (See p. 181.)

(3) The Auditor, Mr. Deibler for Mr. Eric Kohler, of E. L. Kohler and Company. (See p. 182.)

(4) The Managing Editor, Mr. Dewey. (See p. 187.)

(5) The Finance Committee, Mr. Deibler for Mr. C. H. Crennan. (See p. 189.)

(6) The Representatives to the Social Science Research Council, Mr. Millis. (See p. 190.)

Professor Joseph H. Willits reported for the Committee on Permanent Headquarters as follows:

> WHEREAS, The establishment of permanent headquarters jointly with other social science groups, such as the American Sociological Society, the American Statistical Association, and the American Political Science Association, would offer desirable opportunities for formal co-operation on matters of common interest and with the Social Science Research Council; and would open the way to important administrative advantages, and
>
> WHEREAS, The establishment of such a headquarters whether done jointly with other societies or alone, would make it possible for the Association to render better service to its members in a number of ways—such as by stimulating research, by assisting in the preparation of programs, and by rendering other services of a professional character—and
>
> WHEREAS, The establishment of a permanent headquarters might facilitate a consolidation of the duties of the Editor of the *Review* and of the Secretary of the Association; therefore, be it
>
> *Resolved*, That the Association reaffirm its decision to establish a permanent headquarters, and that the Association take steps to develop the details of such a plan, and that the Executive Committee be authorized to proceed with such a project when adequate funds are available, and the problems of personnel can be suitably arranged.

Voted: That the report of the Committee be approved.

President Barnett appointed Professors H. E. Hoagland of Ohio State University, Vanderveer Custis of Northwestern University, and Dr. Meredith Givens of the Social Science Research Council, as a Committee on Resolutions.

Adjourned.

The second business meeting of the American Economic Association was held at 9:00 A.M., December 30, 1932, in the Netherland Plaza Hotel, with President Barnett presiding.

The minutes of the meeting of December 29, 1932, were read and approved.

Professor J. F. Ebersole made a report for the Joint Committee on the Statistics of Income. After setting forth the organization and activities of the Committee (see p. 191), the report presents the following general recommendations:

1. That the Association approve in principle the specific recommendations listed below.
2. That the Association authorize the appointment of a delegation to a new Joint Committee, having power to: (a) fill in technical details of present recommendations; (b) establish and maintain contact, presumably through an agent, with federal officers, with a view to securing their co-operation in obtaining adoption of the proposed changes; (c) continue the investigations of the present Joint Committee, in order to work out further recommendations as needed.
3. That the Association authorize the Joint Committee to select such an agent as implied under 2(b) above, and provide a moderate appropriation for salary and traveling expenses of such an agent, or empower the Joint Committee to seek such an appropriation on the Association's behalf from other sources.

The report was debated and the following action was taken.

Voted: That (1) the report and recommendations of the Joint Committee be adopted; (2) the present representatives of this Association on the Joint Committee be continued; (3) the Executive Committee of this Association be authorized to appropriate funds, in their discretion, for the continuance of the work of the committee members from this Association until and unless the Committee should be able to obtain funds elsewhere; and (4) the Joint Committee be asked to make a special canvass of the technical accounting aspects involved in a change of the form of return and of the suggestions that may be made by the federal bureaus interested in executing the final plan or program.

The following report from the *Encyclopaedia of the Social Sciences* was submitted by Professor E. R. A. Seligman:

During the year 1932 Volumes VII and VIII of the *Encyclopaedia* have appeared, and Volume IX will have appeared before this report is presented. Volume X is almost entirely in the printer's hands and Volumes XI and XII are in a forward state of preparation. We expect Volumes XIII, XIV, and XV to appear without fail in 1934. The enterprise has cost far more than was anticipated at the outset, and negotiations are now in progress with the Rockefeller and Carnegie Foundations, the successful outcome of which is confidently expected, and which will render possible, although with severe sacrifice on our part, the completion of the enterprise.

Voted: That the report be approved.

Professor Morris Copeland of the University of Michigan submitted the following resolution:

Whereas, The nominations of officers of the American Economic Association have heretofore been made by the nominating committee, which committee has followed the practice of making only one nomination for each position to be filled; and

Whereas, The election of officers has heretofore been held at one of the sessions of the annual business meeting of the Association, which sessions are commonly attended by a small proportion of those in attendance at the non-business sessions because of the hour and the number of conflicting engagements, and the electoral procedure at which sessions is commonly in the nature of a confirmation of the nominating committee's selections; and

Whereas, Although these procedures have led to many excellent selections in the past, they now because of the size and the scattered membership of the Association fail to provide adequate and convenient democratic channels for ascertaining the preferences of the vast majority of the Association's members; and

Whereas, These procedures fail to stimulate active interest in the affairs of the Association on the part of its membership; and

WHEREAS, Numerous other organizations now employ electoral procedures which are more convenient and democratic and more adequate to the ends of ascertaining the preferences of the majorities of their electorates and of stimulating organization interest, witness:—the electoral procedure of the Teachers Insurance and Annuity Association of America, the procedures of numerous colleges and universities in the election of alumni trustees, the electoral procedures of the American Psychological Association, the American Mathematical Association, the American Mathematical Society, etc.; therefore, be it

Resolved, That we the undersigned members of the Association respectfully petition you to consider earnestly the advisability of the following:

(1) That the Secretary and Treasurer, and the Managing Editor of the *American Economic Review,* as well as the Counsel, shall be appointed by the Executive Committee.

(2) That for each elective office to be filled the nominating committee shall be instructed to present more than two nominations.

(3) That the election of elective officers shall be conducted either by (a) a ballot to be taken by mail, the ballots and nominations being sent out in the fall with the announcements of the annual December meetings, or by (b) a ballot to be taken both by mail and at a polling place set up at the Association headquarters at the annual meetings.

(4) That in the election of the elective officers a preferential ballot shall be employed.

(5) That, pending the amendment of the by-laws which provide that "the officers of the Association, with the exception of Counsel, shall hereafter be elected at the annual meeting," the balloting for elective officers as specified in (3) and (4) above and the appointments of the newly appointive officers as specified in (1) above shall be regarded technically as a nominating procedure; and that pending the amendment of the by-laws the first choice for each elective position to be filled as ascertained by such balloting and the choices of the Executive Committee for the newly appointive offices shall be presented to one of the sessions of the annual business meeting for confirmation as heretofore.

(6) That the by-laws of the Association shall be amended so as to make possible the taking of the final ballot for elective officers either entirely or partly by mail, and shall be further amended so as to permit the selection by appointment of the officers enumerated as appointive in (1) above.

(7) That the above six proposals shall be submitted to one of the sessions of the annual business meetings at Cincinnati for discussion, and that subsequently and early in 1933 these proposals as amended by action taken on them at the annual business meeting shall be submitted to a vote by mail of the entire membership of the Association.

[Here were attached the signatures of 127 members, the original copies of which are on file in the Secretary's office.—EDITOR.]

Professor Copeland presented the following motion:

That the President in consultation with the Executive Committee appoint a committee on electoral procedure, consisting of three members.

That this committee be instructed as follows:

(1) To put the plan outlined in the petition in form for submission in a referendum to the Association.

(2) If it shall see fit, to prepare an alternative plan or plans of procedure for the selection of officers for submission in referendum.

(3) To prepare such exhibit as may be useful to intelligent voting on the referendum.

(4) To report early in 1933 to the Executive Committee and that the Executive Committee on receipt of such report, shall arrange to conduct a referendum by mail.

After extended debate during which two substitute motions failed by votes of 19 to 17 and 20 to 18, the original motion was carried by a vote of 23 to 14.

Professor H. E. Hoagland presented the following report for the Committee on Resolutions:

Whereas, The success of a series of conventions with an elaborate program of meetings, such as we have enjoyed during the past few days, depends upon first, an enormous amount of preliminary preparation and labor, and second, adequate and efficient hotel accommodations; and

Whereas, The visiting delegates to the Cincinnati conventions of December twenty-eighth to December thirty-first, 1932, desire to make public acknowledgement of their indebtedness to those who are primarily responsible for the high standards of excellence attained by these conventions; therefore, be it

Resolved, That the Secretary tender to Dr. Francis H. Bird, of the University of Cincinnati, chairman of the Committee on Local Arrangements, and to his able associates the warm appreciation and sincere thanks of the officers and members of the America Economic Association for their indefatigable labors in preparing for our convention; and be it further

Resolved, That, in like manner, an expression of the gratitude of the Association be conveyed to our President, to the members of the Program Committee, and of the Publicity Committee, for their contributions to the success of this year's program; and be it further

Resolved, That we extend to Mr. Warner Sayres, chairman of the Cincinnati Convention Bureau, our thanks for his efforts to make our visit to his city pleasant and comfortable; and be it further

Resolved, That our thanks be extended also to the management of the Netherland Plaza for its friendly co-operation in arranging for the necessary physical facilities for our meetings, and to the local press for the generous publicity accorded our discussions.

The resolutions were adopted and the Secretary was instructed to send copies in accordance with the instructions contained therein.

Voted: That the determination of the next place of meeting be referred to the Executive Committee with power.

Professor E. W. Kemmerer reported for the Nominating Committee the following list of nominations:

For President: W. Z. Ripley, Harvard University.

For Vice-Presidents: H. L. Moore, Columbia University; W. W. Stewart, New York City.

For Secretary-Treasurer: F. S. Deibler, Northwestern University.

For Members of the Executive Committee: D. A. McCabe, Princeton University; Stuart Daggett, University of California.

For Members of the Editorial Board: A. B. Wolfe, Ohio State University; C. Goodrich, Columbia University.

For Member of the Program Committee: S. H. Slichter, Harvard University.

For Representative to the Social Science Research Council: H. A. Millis, University of Chicago.

There being no additional nominations, the Secretary was instructed to cast a ballot, and the nominees were declared duly elected.

Adjourned.

REPORT OF THE SECRETARY OF THE AMERICAN ECONOMIC ASSOCIATION FOR THE YEAR ENDING DECEMBER 15, 1932

In order to record all of the activities of the Association for the year just closed, I am including the minutes of all meetings of the Executive Committee held within the year.

(1) Minutes of the first meeting of the 1932 Executive Committee:

The first meeting of the Executive Committee of the American Economic Association for the year 1932 was held in the Cosmos Club, Washington, D.C., March 12, 1932, at 10:00 A.M. There were present: President Barnett, presiding, and Messrs. Bogart, Deibler, Dewey, Gay, Hammond, Heilman, Ise, Mitchell, Tucker, and Wolman.

Voted: To appoint Dr. Edmund E. Day a member of the Joint Census Advisory Committee for the term 1932 to 1934.

Voted: To appoint the President, the Secretary, and one representative to the Social Science Research Council as a committee for the purpose of investigating, in co-operation with the Social Science Research Council, the possibilities of stimulating and aiding research in the field of economics, and the reporting to the next annual meeting of a plan for the accomplishment of this purpose.

Professor Max Handman was named as a member and chairman of the committee.

Mr. R. A. Sawyer, chairman of the Public Documents Committee of the American Library Association, requested the opinion of the American Economic Association on the question of the change from free distribution of public documents to distribution by sale only.

Voted: That with the information before it, the Executive Committee is not prepared to take action recommending the restriction of the present depository system and method of distributing public documents.

Voted: To appoint J. F. Ebersole, Ralph C. Epstein, and Murray Haig members of a joint committee with members of the American Statistical Association and the American Association of University Instructors in Accounting, for the purpose of urging the United States Treasury Department to publish additional statistical data on incomes.

Voted: To appropriate not to exceed $150 to defray the expenses of this committee.

The information was brought to the attention of the Executive Committee that some of the other associations were contemplating the establishment of permanent headquarters.

Voted: That the President appoint a committee to consider the possibility of common action with other associations in the establishment of permanent headquarters.

Voted: That the present Committee on the World's Fair meeting be continued, and be given full authority in the development of a program for this meeting.

Professor Emerson P. Schmidt, of the University of Minnesota, requested the privilege of reprinting the addresses of the presidents of the Association in a volume to contain a brief history of the Association by Dr. Ely and the pictures and a brief biographical note concerning each of the presidents.

Voted: That it is the opinion of the Executive Committee that the proposed volume would be more appropriate as an official publication of the Association, and therefore the Committee hesitates to give its sanction for the reprinting of these addresses.

Voted: That, because of his long, continuous membership, Professor J. William Black (Union College, Schenectady, New York) be granted a complimentary membership.

Voted: That the *Social Science Abstracts* be granted not to exceed a half page of advertising in each issue of the *Review*.

Professor H. G. Shields, president of the National Education Association, requested the appointment of a joint committee to consider the advisability of increasing the amount of instruction in economics in the secondary schools.

Voted: That the Executive Committee express to Professor Shields its sympathy with his proposal, but owing to the difficulty of the problem it was thought wise that a more definite proposal should be presented before action is taken.

Voted: That the dates of the next annual meeting be December 28, 29, and 30.

Voted: That the President and the Secretary be authorized to appoint a committee on local arrangements.

After an informal discussion of the program for the next annual meeting, the Committee adjourned.

(2) Minutes of the second meeting of the 1932 Executive Committee:

The second meeting of the Executive Committee of the American Economic Association for the year 1932 was held in the Netherland Plaza Hotel, Cincinnati, Ohio, December 28, 1932, at 5:00 P.M. There were present: President Barnett, presiding, and Messrs. Anderson, Bogart, Deibler, Dewey, Hammond, Ise, Mitchell, and Willits.

Voted: That the American Economic Association reaffirm its original approval of the work of Congress in providing for the preparation of an Index and Digest of State Legislation and express its continued faith in the usefulness of this work.

Voted: That the President, Vice-Presidents, and other proper officers be authorized to file such papers as are required by the State Bank and Trust Company, of Evanston, Illinois, the bank of deposit for the funds of the Association, and to provide for the proper drawing of checks against the funds of the Association.

Voted: That the appropriation of $150 for the expenses of the Committee on Permanent Headquarters, that was authorized by the Executive Committee by a vote by mail, be approved.

Voted: That the problems arising from the unsettled condition of foreign exchange as they affect dues and subscriptions be left for the determination of the Secretary.

Professor Copeland presented a resolution requesting a change in the election procedure. After informal discussion it was agreed that Professor Copeland should present the resolution to the business meeting of the Association on December 30, 1932.

Professor J. F. Ebersole made an extended statement on the work of the Joint Committee on Statistics of Income. After a discussion of the report, the Executive Committee expressed the opinion that further consideration should be given to the accounting features of the proposals as well as to ways and means of securing the co-operation of the officers of the United States Treasury Department, and that the Committee should be continued for this purpose. The Executive Committee requested Professor Ebersole to prepare an appropriate report and resolution embodying the results of the work of the Joint Committee, including the suggestions made by the Executive Committee, to be presented to the business meeting of the Association on December 30, 1932. Adjourned.

(3) Minutes of the third meeting of the 1932 Executive Committee:

The third meeting of the Executive Committee of the American Economic Association was held in the Netherland Plaza Hotel, Cincinnati, Ohio, December 29, 1932, at 5:00 P.M. There were present: President Barnett, presiding, and Messrs. Anderson, Bogart, Deibler, Dewey, Hammond, Ise, and Mitchell.

Voted: That the report and recommendations of the Committee on Research be approved. (See p. 195)

Voted: That the handbook be printed as a supplement to the June issue of the *Review*.

Voted: That Mr. John E. Walker be reappointed as counsel of the Association for the year 1933.

Voted: That Messrs. C. H. Crennan, George B. Roberts, and F. S. Deibler be reappointed as the Finance Committee.

Voted: That Leo Wolman be reappointed as a representative on the Joint Census Advisory Board.

Dr. H. G. Moulton submitted the following report for the special committee on program for a special meeting to be held in June, 1933, in connection with the Century of Progress in Chicago:

I submit herewith a report for the Committee appointed to consider holding a special meeting of the American Economic Association, in conjunction with other associations, in connection with the World's Fair. The Committee was in favor of the plan, provided it could have the support of the Social Science Research Council. The Council gave the matter consideration at its meeting in September and reports as follows:

"The Council has taken definite action abandoning the World Congress of Social Scientists at the Fair which has been under consideration for some time. It was felt that there are so many uncertainties in the situation at the Fair that we are still in no position to do anything about a Congress; that even though those uncertainties had been cleared up, the time is very short in which to prepare effectively."

In the light of this action on the part of the Council, I would recommend that the project be given up.

The Secretary reported his conversations with Professor Irving Fisher who had just come from a session of Section K of the American Association for the Advancement of Science. It was reported that Professor Fisher was strongly in favor of the proposal that the American Economic Association hold a session in connection with the Fair. After due deliberation, the following vote prevailed.

Voted: That the report of the Committee be approved.

Voted: That the Secretary be requested to communicate with Professor J. Russell Smith and explain the policy of the American Economic Association in connection with proposals such as those contained in his letter of December 19, 1932.

Professor Stuart Rice submitted the following resolution, with the statement that a similar resolution was being submitted to the American Statistical Association, the American Sociological Society, and the American Political Science Association:

WHEREAS, Unusual population movements have occurred since the Census of 1930 between city and country and within cities; therefore, be it

Resolved, By the American Economic Association assembled in its annual meeting at Cincinnati, Ohio, December 28-30, 1932, that in its opinion a population census of the United States should be taken, intermediate between the decennial enumerations of 1930 and 1940; that this population census should be synchronized with the next quinquennial census of agriculture; and that this resolution should be brought by the Association to the attention of the President of the United States, the Secretary of Commerce, the Director of the Census, and members of the Congress of the United States; and that the officers of the Association be instructed, in co-operation with other interested organizations, to take all steps available to them to promote the objects herein set forth.

Voted: That in view of the present financial conditions of the country and the pressure on Congress to economize, it was thought inadvisable to make requests for additional appropriations at this time.

Dr. Meredith Givens presented the following resolution:

WHEREAS, The social scientists are directly interested in the scientific work of the several departments of government; therefore, be it

Resolved, That this Association authorize the appointment of two representatives on an interassociation committee of the social sciences to explore this whole subject with a view to making social scientists more effective in this area, and

Resolved, That the American Economic Association join with the American Political Science Association, the American Statistical Association, and the American Sociological Society in appointing representatives to such a committee, and

Resolved, That the committee thus formed shall be authorized to take action in any specific cases which may call for immediate attention.

Voted: That the representatives of the American Economic Association on the Joint Census Advisory Committee be authorized to represent this Association, and that they be instructed to exercise their judgment in co-operating with representatives of the other associations in endorsing personnel for scientific appointments in government service.

Adjourned.

Minutes of a special meeting of the 1932 Executive Committee:

A special meeting of the Executive Committee of the American Economic Association was held in the Netherland Plaza Hotel, Cincinnati, Ohio, December 30, 1932, at 12:00 M. There were present: President Barnett, presiding, and Messrs. Anderson, Bogart, Deibler, and Dewey.

It was reported to the Executive Committee that the newly-elect President and the two Vice-Presidents were out of the country. The Secretary was instructed to verify this report. The attention of the Secretary was then called to the constitutional provision (Article IV, Section 1 of the By-laws) which under the reported circumstances, if verified, would require him to assume the duties of the President.

Adjourned.

The office of the Secretary has carried on the regular business of the Association during the current year.

The *Proceedings* of the annual meeting of 1931 were edited and published as a supplement to the March, 1932, issue of the *Review*.

President Barnett made the following appointments during the year:

NOMINATING COMMITTEE:
E. W. KEMMERER, *Chairman*
J. M. CLARK
M. A. COPELAND
I. LIPPINCOTT
M. H. ROBINSON
H. R. TOSDAL

AUDITORS:
E. L. KOHLER AND COMPANY

COMMITTEE ON LOCAL ARRANGEMENTS:
F. H. BIRD, *Chairman*

JOINT COMMITTEE ON STATISTICS OF INCOME:
RALPH C. EPSTEIN
MURRAY HAIG
J. F. EBERSOLE

REPRESENTATIVE OF THE ASSOCIATION AT GETTYSBURG COLLEGE CENTENARY:
R. S. SABY

APRIL MEETING OF ACADEMY OF SOCIAL AND POLITICAL SCIENCE:
L. L. LORWIN
R. G. TUGWELL
S. H. SLICHTER

DELEGATE TO AMERICAN HOME ECONOMICS ASSOCIATION:
EDGAR H. JOHNSON

REPRESENTATIVE AT THE OPENING OF THE LIBRARY OF THE UNIVERSITY OF DENVER:
JOHN D. CLARK

REPRESENTATIVE AT CONFERENCE OF UNIVERSITIES AT NEW YORK UNIVERSITY:
E. R. A. SELIGMAN

In accordance with a resolution of the Executive Committee (Vol. XX, Sup. 1, p. 184), the President and Secretary have approved the use of the addressograph list of the Association by:

Frank D. Graham, for notification of his book on *The Abolition of Unemployment*.

New York Central Railroad Company, for circularizing members about train service to annual meeting.

The Association has continued its co-operation with the Pollak Foundation, the Adelphi Company, and the Royal Economic Society, by which members of the Association may secure publications of these companies or associations at reduced rates. This service to the membership has been effected without cost to the Association.

The following table shows the present status of the membership and the changes that have occurred during the year ending December 15, 1932, the date of closing the books of the Association:

Total members and subscribers in December, 1931			3781
Annual members in December, 1931		2626	
Members removed in 1932:			
Resigned	104		
Lack of address	28		
Non-payment of dues	185		
Died	16	333	
		2293	

Members added in 1931		195	
Total annual members in December, 1932		2488	
Life members in December, 1931	64		
Removed in 1932	2		
Total life members in December, 1932		62	
Honorary members in December, 1931	15		
Removed in 1932	1		
	14		
Added in 1932	5		
Total honorary members in December, 1932		19	
Total members in December, 1932		2569	
Subscribers in December, 1931	1076		
Removed in 1932	189		
	887		
Added in 1932	171		
Total subscribers in December, 1932		1058	
Total members and subscribers, December, 1932			3627
Net loss			154

The net loss for the year was 154. The prolonged depression is responsible for this decline, as the correspondence has shown that many members and libraries as well have had to suspend their affiliation with the Association on account of a lack of funds.

The number of resignations of members and removals for non-payment of dues, together with discontinuances of subscribers, were larger than last year and account for nearly half of this loss. In addition the number of new members and subscribers was less than received last year. The Secretary takes this opportunity to express his appreciation for the co-operation received from members in nominating persons for membership, and earnestly appeals for added help in maintaining the membership during the coming year.

We regretfully report that during the year the deaths of the following members have been reported, and that we have had to remove their names from the active membership list:

Avard L. Bishop
Roland W. Boyden
Harry J. Brandt
Robert W. De Forest
George Eastman
Eugene L. Fisk
Hugh McKay Fletcher
Franklin H. Giddings
Charles Gide (Honorary Member)
James F. Glen
Francis A. Hardy
P. Hughes
George P. Miller
William Gardner Reed
Julius Rosenwald
Mortimer L. Schiff (Life Member)
Fred Manville Taylor
W. W. Underwood
H. Walters (Life Member)

Respectfully submitted,

F. S. Deibler, *Secretary*

REPORT OF THE TREASURER OF THE AMERICAN ECONOMIC ASSOCIATION FOR THE YEAR ENDING DECEMBER 15, 1932

The members of the Association are referred to the report of the Auditor for a statement of the financial condition of the Association at the date of the audit. The current assets and liabilities are shown in Exhibit I. The income and expenditures for the year appear in Exhibit II. The total assets of the Association now amount to $47,498.00. This figure carries the investments at cost, which is $7,894.78 above their present market value, which represents a decline of $1,067.74 during the year. It does not include the stock of unsold copies of the past publications of the Association, which have been charged as an expenditure against past income. The Association derives a considerable income yearly from this source. During the last five years this income has amounted to $3,754.58, or an average of $750.00 per year.

The total receipts, including dues, interest, advertising, sales, and miscellaneous items amounted to $21,288.84, or $1,078.27 less than for the year 1931. The net income from dues was lower by $782.09, and publication income by $375.08 than for the previous year. These two items alone account for the decline in yearly income. Economies in publication costs were sufficient to offset the loss in income and enabled the Association to close the year with a net addition to surplus of $1,656.11.

The administrative and operating expenses were higher than for the year 1931, which is accounted for by the Executive Committee expense. This item fluctuates from year to year because of the traveling expense of Committee members in attendance at the spring meeting of the Committee.

The investments of the Association have been given the most careful scrutiny, and while their present market value is below their cost, they are, in the opinion of your Finance Committee, invested in securities of high grade concerns.

It will be necessary, during the coming year, for the Association to maintain its income from dues and subscriptions and to effect further economies in its expenses to show a favorable report at the close of the year 1933. With due care in these two directions the present activities of the Association can be maintained within the yearly income of the Association.

Respectfully submitted,

F. S. Deibler, *Treasurer*

REPORT OF THE AUDITOR

December 22, 1932

Executive Committee,
American Economic Association, Inc.,
Evanston, Illinois.

DEAR SIRS:

We have completed the annual audit of the books and records of the American Economic Association, Inc., for the year from December 12, 1931, to December 15, 1932, and present the following exhibits together with our report thereon:

Exhibit	*Number*
Balance sheet—December 15, 1932	I
Statement of income and expense—Year ending December 15, 1932	II

Results from Operations

The year ending December 15, 1932, yielded a net income of $1,656.11, an increase of $41.49 over the previous year, as shown by the following condensed comparison of the operating results of the two periods:

Particulars	Year ending December 12, 1931	Year ending December 15, 1932	Increase or *decrease*
Income from—			
Dues	$13,535.60	$12,753.51	$ *782.09*
Interest on investments and bank balances	2,211.49	2,151.20	*60.29*
Loss on securities sold	*321.85*	....	321.85
"Economic Essays"	12.56	149.62	137.06
Other sources	2.38	4.51	2.13
Total income	$15,440.18	$15,058.84	$ *381.34*
Expenses and costs—			
Administrative and other operating expenses	$ 5,587.67	$ 5,957.43	$ 369.76
Publication costs	14,852.97	13,675.30	*1,177.67*
Publication income	*6,615.08*	*6,230.00*	385.08
Total expenses and costs	$13,825.56	$13,402.73	$ *422.83*
Net income	$ 1,614.62	$ 1,656.11	$ 41.49

A decrease of 154 in the membership roll was sustained during the year 1932; in 1931 there was a decrease of 78 members.

The principal increase in administrative and other operating expense was caused by the Executive Committee expense of $525.94, which was $169.58 in excess of the 1931 expenditure, and the expense of the Income Statistics Committee of $200.82, which was $50.82 in excess of the appropriation made therefore by the Executive Committee.

The following summary presents a comparison of the publication income and expenses for 1931 and 1932 and the budget for 1932 submitted by the managing editor:

Particulars	Year 1931	Year 1932	Budget for 1932
Income—			
Subscriptions other than from members	$ 5,132.45	$ 5,017.31	
Sales of copies	749.06	608.54	
Advertising	733.57	604.15	
Total income	$ 6,615.08	$ 6,230.00	
Expenses—			
Printing	$ 5,648.20	$ 5,189.41	$ 5,400.00
Editor's honorarium	2,500.00	2,500.00	2,500.00
Contributions	1,453.25	1,451.00	1,500.00
Proceedings	1,919.18	1,819.75	....
Handbook	589.54	....	....
Other costs	2,742.80	2,715.14	2,600.00
Total expenses	$14,852.97	$13,675.30	$12,000.00
Net expenses	$ 8,237.89	$ 7,445.30	

The above budget was based on a printing of 4,300 copies, and was maintained until December when it was decreased by 200 copies. The total pages for the year were 828. During 1931 4,400 copies of each issue were printed and the total pages were 836.

No handbook was published during 1932; 4,200 copies of the *Proceedings*, constituting 316 pages, however, were published at a cost of $1,819.75; the 4,300 copies of the 1931 *Proceedings*, containing 308 pages, cost $1,919.18.

Balance Sheet—December 15, 1932

Cash in checking and savings accounts was reconciled with a certificate received from the State Bank and Trust Company, Evanston, Illinois.

The investment securities, with the exception of $2,000.00 of certificates of deposit which we examined, were in the custody of the State Bank and Trust Company, who furnished us with a certified list thereof. At December 12, 1931, the finance committee made a detailed report of the securities owned; the only change in the holdings thereafter was the purchase of the certificates of deposit.

The membership extension fund was decreased during the year 1932 by $143.61, which was spent for printing, postage, and salaries.

Two life memberships of $100.00 each were transferred to unappropriated surplus on account of the death of members.

Changes in Financial Condition

The changes in the financial condition of the Association during the year 1932 are contained in the following condensed comparison of the balance sheets at December 12, 1931, and December 15, 1932:

Assets	December 12, 1931	December 15, 1932	Increase or *decrease*
Cash in bank	$ 3,863.61	$ 3,404.30	$ *459.31*
Investments, at cost	39,134.48	41,134.48	2,000.00
Receivables, net	1,013.25	951.95	*61.30*
Inventories, at cost	1,611.72	1,593.62	*18.10*
Furniture, fixtures, etc., at cost	1,139.99	1,141.84	1.85
Reserve for depreciation	*636.84*	*728.19*	*91.35*
Total assets	$46,126.21	$47,498.00	$1,371.79

Liabilities and Net Worth			
Accounts payable	$ 138.95	....	$ 138.95
Unearned income	2,272.49	$ 2,270.73	1.76
Membership extension fund	4,667.73	4,524.12	143.61
Life memberships	5,550.00	5,350.00	200.00
Surplus—			
Balance—December 12, 1931	33,497.04	33,497.04	....
Net income for the year ending December 15, 1932	....	1,656.11	1,656.11
Transfer from life memberships to surplus—1932	....	200.00	200.00
Total liabilities and net worth	$46,126.21	$47,498.00	$1,371.79

We appreciate the courtesies extended to us during the course of the audit.

Very truly yours,

E. L. KOHLER AND COMPANY
Certified Public Accountants

EXHIBIT I

AMERICAN ECONOMIC ASSOCIATION, INCORPORATED

BALANCE SHEET, DECEMBER 15, 1932

Assets

CURRENT ASSETS AND INVESTMENTS:			
Cash in State Bank and Trust Company, Evanston, Illinois		$ 3,404.30	
Investments, at cost		41,134.48	
Receivables—			
Review advertising	$ 156.00		
Interest accrued on investments	545.03		
Membership dues	458.75		
Publication sales	173.17		
Subscriptions	19.00		
Total receivables	$ 1,351.95		
Less—Reserve for doubtful accounts	400.00	951.95	
Inventories, at cost—			
"Economic Essays"	$ 1,219.20		
Cover stock	134.62		
Stamped envelopes	239.80	1,593.62	$47,084.35
FURNITURE, FIXTURES AND BOUND PERIODICALS, at cost		$ 1,141.84	
Less—Reserve for depreciation		728.19	413.65
Total assets			$47,498.00

Liabilities and Net Worth

CURRENT LIABILITIES:			
Unearned income—			
Membership dues		$ 292.50	
Subscriptions		1,978.23	$ 2,270.73
MEMBERSHIP EXTENSION FUND			4,524.12
NET WORTH:			
Life memberships		$ 5,350.00	
Surplus unappropriated—			
Balance—December 12, 1931	$33,497.00		
Net income—Year ending December 15, 1932 (Exhibit II)	1,656.11		
Transfer from life memberships	200.00	35,353.15	40,703.15
Total liabilities and net worth			$47,498.00

EXHIBIT II

AMERICAN ECONOMIC ASSOCIATION, INCORPORATED

Statement of Income and Expense
Year Ending December 15, 1932

Particulars			*Amount*	
Income From Dues:				
Regular members (less $365.00 defaulted dues unpaid at December 15, 1932)			$12,371.01	
Subscribing and contributing members			382.50	$12,753.51
Other Income:				
Income from investments—				
Interest earned on—				
Bonds		$ 2,014.36		
Certificates of deposit		108.74		
		$ 2,123.10		
Less—Custodian's fee		39.50	$ 2,083.60	
Interest earned on savings and checking accounts			67.60	
Royalties on "Economic Essays"			147.87	
Profit on sale of "Economic Essays"			1.75	
Miscellaneous income			4.51	2,305.33
Total income				$15,058.84
Administrative and Other Operating Expenses:				
Secretary's salary		$ 1,000.00		
Office salaries		2,963.34		
Postage		326.19		
Stationery and printing		113.15		
Office supplies		30.25		
Telephone and telegrams		66.48		
Insurance		78.10		
Depreciation		91.35		
Annual meeting		374.72		
Executive Committee expense		525.94		
Income Statistics Committee expense		200.82		
American Council of Learned Societies		65.00		
Auditing		50.00		
Other expenses		72.09	$ 5,957.43	
Publication Expenses:				
Printing		$ 5,189.41		
Editor's honorarium		2,500.00		
Editor's traveling expenses		47.46		
Editorial expenses and supplies		2,638.67		
Contributions		1,451.00		
Proceedings		1,819.75		
Sundry publication expense		29.01		
Total publication expenses		$13,675.30		
Publication income—				
Subscriptions other than from members	$5,017.31			
Sales of copies	608.54			
Advertising	604.15	6,230.00	7,445.30	
Total expenses				13,402.73
Net income for year (Exhibit I)				$ 1,656.11

REPORT OF THE MANAGING EDITOR OF THE AMERICAN ECONOMIC REVIEW FOR THE YEAR ENDING DECEMBER, 1932

The cost of the *Review* during 1932 was $11,780.36, as compared with $11,982.29 for 1931. There will be a small additional amount for postage on the excerpts and reprints for the December number, the charge for which had not come from the printer when the books of the treasurer had to be closed. The total expenditure is slightly less than the budget estimate made a year ago, namely, $12,000.00.

The number of copies printed averaged 4,250 per issue, as compared with 4,400 in 1931. The number of pages in the volume just completed is also somewhat less—792, as compared with 814.

The expenses during 1932 by principal items were as follows:

Printing (paper, reprints, postage, etc.)	$ 5,143.23[1]
Editorial	2,500.00
Clerical	2,300.00
Supplies	386.13
Contributors	1,451.00
	$11,780.36

On the basis of printing 4,100 copies the following budget for 1933 is submitted:

Printing (paper, reprints, postage, etc.)	$ 5,400.00
Editorial	2,500.00
Clerical	2,300.00
Supplies	300.00
Contributors	1,500.00
	$12,000.00

The following persons have served as editors during the past year: Professors F. B. Garver and N. S. B. Gras, whose terms expire this year; Dr. L. C. Gray and Professor M. W. Watkins, whose terms expire in 1933; and Professors F. A. Bradford and P. T. Homan, whose terms expire in 1934. During the year 213 persons have co-operated in writing leading articles, communications, reviews and notes.

On September 13 the Social Science Research Council voted to discontinue *Social Science Abstracts* with the end of Volume IV for 1932. The editors of the *Review*, therefore, have under consideration the question of resuming abstracts in our *Review*. It appears, however, impracticable to reach an immediate decision until after the meeting of the board of directors of *Social Science Abstracts*, which will be held January 5. Suggestions have been made for continuation of the abstracts by a commercial firm. If a satisfactory arrangement can be made, it would seem inadvisable for the *Review* to undertake this service. If the abstracting, however, be resumed by the *Review*, the editors believe that a different plan should be adopted from that in use from 1911 to 1928.

[1] The Editor's report is based on the calendar year. The Treasurer's and the Auditor's reports are on the fiscal year December 12, 1931, to December 15, 1932.

Another question which is under discussion by the board of editors is the publication of the thesis list as a separate supplement. This list encroaches upon the space available for articles and reviews; and it is believed by some that this could be more serviceable if printed as a separate pamphlet in the same way as is the list of members.

Respectfully submitted,
DAVIS R. DEWEY, *Managing Editor*

TABLE I
PAGES GIVEN TO EACH SECTION*

Year	Leading articles	Reviews	New books listed	Documents, reports, etc.	Periodical abstracts	Notes	Theses	Totals
1920	395	109	155	98	122	42	15	936
1921	331	103	133	39	117	38	11	772
1922	293	91	158	35	124	37	13	752
1923	298	122	184	26	113	43	14	800
1924	339	110	191	23	113	42	18	836
1925	325	131	178	27	110	38	23	832
1926	270	137	184	15	108	43	27	784
1927	262	120	195	32	114	42	27	792
1928	335	111	176	12	121	45	28	828
1929	315	181	173	18	1	52	28	768
1930	348	154	210	12	0	58	29	811
1931	369	170	197	13	0	40	25	814
1932	351	175	203	12	0	27	24	792

* Figures for 1911–19 may be found in the report for 1930, published in the *Supplement*, March, 1931, p. 284.

TABLE II
EXPENDITURES

Year	Printing	Salary of editor	Payments to contributors	Clerical	Supplies	Totals
1920	$6,656.31	$1,500.00	$1,122.75	$1,595.64	$307.20	$11,181.90
1921	5,646.97	1,500.00	64.50	1,472.50	319.97	9,003.94
1922	4,795.28	1,500.00	—	1,370.00	314.77	7,980.05
1923	5,032.59	1,500.00	—	1,650.09	437.86	8,620.54
1924	5,423.28	1,500.00	1,110.25	1,464.01	305.32	9,802.86
1925	5,713.01	1,500.00	1,133.50	1,757.32	406.36	10,510.19
1926	5,332.24	1,500.00	1,128.00	1,589.86	323.43	9,873.53
1927	5,619.20	1,500.00	1,013.75	1,806.50	297.25	10,236.70
1928	5,321.95	1,500.00	1,190.50	1,956.50	375.37	10,344.32
1929	4,927.62	1,500.00	1,328.75	2,004.50	261.72	10,022.59
1930	5,386.67	2,500.00	1,447.75	2,253.00	347.80	11,935.22
1931	5,399.94	2,500.00	1,454.75	2,300.00	327.60	11,982.29
1932	5,143.23	2,500.00	1,451.00	2,300.00	386.13	11,780.36

REPORT OF THE FINANCE COMMITTEE

There have been no changes in the investment list during the year ending December 15, 1932. Notice has been received that Sinclair Crude Oil Purchasing Company 10 year, Series "A" 5½'s, due 1938, have been called for payment at 101½ on January 16, 1933.

The total investment list of the Association, carried at cost or market, whichever is lower, now amounts to $30,684.70. The market value of the list on December 21 was $7,894.78 below cost, a decline of only 2.7 per cent during the year. The investments of the Association have been formally reviewed quarterly by your Committee, and have in fact been investigated much more frequently than this. The annual interest return from this list now amounts to $2,014.37.

Your Committee has regarded the portfolio of the Association as an investment account. It has followed the policy of watching for stability of earnings of the issuing companies, and their ability to meet the principal account at its maturity. During one of the most prolonged and serious depressions in the history of our country, the Committee is glad to report that there has been no default to date of either interest or principal.

The list, at market or cost, whichever is lower, stands as follows:

$1,000	Alabama Power Co. 1st Mtge. Lien and Ref. 5's, due 1956	$ 900.00
2,000	Bell Telephone Company of Pa. 1st and Ref. 5's, due 1948	1,973.00
1,000	By-Products Coke Corp. 1st Mtge. 5½'s, due 1945	460.00
1,000	Chicago, Rock Island & Pacific Equip. Tr. Series "P" 4½'s, due 1936	600.00
1,000	City of Cleveland Water Works 4½'s, due 1938	970.00
1,000	City of New York Corp. Stock Water 4's, due 1980	850.00
2,000	Commonwealth Edison Co. 4's, due 1981	1,760.00
1,000	Crown Willamette Paper Co. 1st S.F. 6's, due 1951	640.00
1,000	Detroit Edison Co. Gen. and Ref. Series "D" 4½'s, due 1961	970.00
1,000	Erie Railroad Co. Ref. and Imp. 5's, due 1975	250.00
2,000	Great Northern Railway Co. Gen. Mtge. 7's, due 1936	1,180.00
2,000	Illinois Bell Telephone Co. 1st and Ref. "A" 5's, due 1956	2,007.50
2,000	Illinois Central Railroad Co. 1st and Ref. "A" 5's, due 1963	780.00
1,000	Louisville Gas and Elec. Co. 1st and Ref. 5's, due 1952	915.00
1,000	National Dairy Products Corp. 5¼'s Debentures, due 1948	850.00
1,000	North American Edison Co. Deb. Series "C" 5's, due 1969	760.00
6,000	Northern Pacific Railway Co. Ref. and Imp. 6's, due 2047	3,300.00
1,000	Ohio Power Co. 1st and Ref. "D" 4½'s, due 1956	950.00
2,000	Pacific Gas and Electric Co. 1st and Ref. 5½'s, due 1952	1,970.00
2,000	Pacific Mills, Ltd. 1st Serial 6's, due 1935	1,460.00
1,000	Pennsylvania Railroad Co. Deb. 4½'s, due 1970	630.00
1,000	Sinclair Crude Oil Purchasing Co. 10-yr Series "A" 5½'s, due 1938	1,010.00
1,000	Southern Ill. and Mo. Bridge Co. 4's, due 1951	520.00
1,000	Southern Pacific Railway 50-Yr 4½'s, due 1981	450.00
1,000	United Biscuit Co. 6's, due 1942	970.00
1,500	United States of America Treasury 3⅛'s, due 1949	1,484.20
2,000	United States of America 4th Liberty Loan 4¼'s, due 1938	2,075.00

Respectfully submitted,

C. H. Crennan, *Chairman*
George B. Roberts
F. S. Deibler

REPORT OF THE REPRESENTATIVES OF THE ASSOCIATION ON THE SOCIAL SCIENCE RESEARCH COUNCIL

Your representatives on the Social Science Research Council submit this brief report. Its brevity is explained in part by the fact that during the past year the Council has devoted its attention more to watching and appraising its work under way than to initiating new ventures. This is explained by the stage its projects have been in, not by lack of promising new things it might undertake.

Three facts of interest to the general membership of our Association may be mentioned. (1) The Council and its work have been satisfactorily refinanced for a new period. This means that donors have regarded the work done and in prospect as worth while. (2) After many discussions and a survey of the use made of *Social Science Abstracts,* the Council at its September conference voted to discontinue this publication with the present volume (and index). It should be said that this action contains no reflection upon the work done by those connected with the *Abstracts.* That work has been well done. The *Abstracts,* however, failed to be inclusive enough to satisfy those with a highly specialized and bibliographical interest, or to be long enough to satisfy those who do not have access to the abstracted article or cannot read it in the language in which printed. Investigation showed that only a limited number of social scientists have made much use of the *Abstracts.* In view of this fact and in view of the seeming impossibility of devising at this time a superior service, the Council felt itself unable to assume responsibility for requesting a new grant to continue this publication. (3) A committee has made an extended study of recruitment and fellowships in the social sciences and presented a provisional report, the distribution of which awaits the results of further investigation. The Council feels that there is serious need for fellowships for really promising persons immediately upon graduation from college. Certainly in past years many promising young persons have been unable to enter upon graduate work with the object in view of becoming trained social scientists. The Council now proposes to experiment with such fellowships in limited number, while continuing its fellowships at the post-doctoral level. The Council feels, also, that there is a dearth of fellowships of the type that leaves the holder free to select his place of study and to move from one institution to another as the best program may require.

Respectfully submitted,

MAX HANDMAN
H. A. MILLIS
A. B. WOLFE

REPORT ON THE ORGANIZATION AND ACTIVITIES OF THE JOINT COMMITTEE ON STATISTICS OF INCOME

Early in the year the three interested associations appointed a delegate to the Joint Committee on the Statistics of Income as follows: the American Association of University Instructors in Accounting, Professor James L. Dohr (Columbia), Professor Howard C. Greer (Chicago), and Professor William A. Paton (Michigan); the American Economic Association, Professor J. Franklin Ebersole (Harvard), Professor Ralph C. Epstein (Buffalo), and Professor Robert Murray Haig (Columbia); and the American Statistical Association, Professor William L. Crum (Harvard), Professor Willford I. King (New York University), and Dr. Simon S. Kuznets (National Bureau of Economic Research).

The Joint Committee met in New York on June 1, 1932, elected Dr. King its chairman, adopted certain general principles to guide its study of the problem assigned to it, discussed at some length certain of the more significant specific criticisms and suggestions relating to the federal income tax statistics, and established a subcommittee empowered to consider the mass of suggestions submitted. This subcommittee (Ebersole, Epstein, Kuznets, and the chairman) met immediately in New York, and prepared a preliminary summary and report as a basis for further consideration, by correspondence and otherwise.

During the summer, consideration of this preliminary summary, and of various specific suggestions which were submitted by or on behalf of the different members of the Joint Committee, proceeded by mail. The members of the subcommittee (to which, by consent, Crum had been added) examined in detail the various proposals, and exchanged communications concerning the major points of interest. The preliminary summary, with subsequent notations and addenda, was thus made ready for consideration at the November meeting of the Joint Committee. The Joint Committee held a second meeting in New York on November 18, adopted the preliminary summary as the basis of discussion, and after amending this summary extensively and in detail, adopted the recommendations presented below—a draft of which was ordered made by Crum, from elaborate minutes submitted to him by the chairman.

Early in our work, it appeared desirable to adopt certain general aims to guide our investigation and to insure the organization of our program of changes along lines which could be defended in the event of their submission to government officials for action. These general aims can be summarized briefly as follows:

The Bureau of Internal Revenue now collects and publishes certain data on the annual flow of incomes, corporation incomes and expenditures, and balance sheet items. The existing information can be used to build an annual picture of the flow of purchasing power to individuals (above a certain income range), and of changes in the business activity and financial structure of most American corporations. But the existing tabulations omit many possible classifications and combinations of the data, which would be as

important as, or perhaps more important than, the present tabulations as a means of throwing light upon fundamental economic processes. We are fully aware that the primary purpose of the income tax return is to facilitate administration of the tax, and we are not in favor of overloading the tax blank with questions which are important only to economists and statisticians. But we do believe it is important to secure information, the proper study of which will enable legislative bodies and all interested citizens to understand and appraise the income tax from the point of view of its impact upon the total flow of income in the nation. The wisdom of future tax policy will depend considerably upon the degree of our knowledge of the basic facts which presumably will be brought to light by some of the proposed changes. The sweep of governmental interest in economic and business matters is now so wide that the information is likely to be revealed by every item of the proposed changes and will be of large usefulness in guiding legislative policies. In fact very few changes are being recommended in the tax blank. This is partly because the bulk of the information which now seems desirable to be added to that already published can readily be compiled from the returns as they are now filed, and partly to avoid at this time recommendations which would entail extensive administrative acts and adjustments. Only the most pressing changes which involve alterations in the tax blank are suggested at this time.

It seemed wise to work out the specific recommendations in great detail; and, although it has been necessary to present many of them to the associations only in such form as makes evident the principle involved, it is assumed that great care will be exercised to complete the detail and render each recommendation tangible and definite before its final submission to Washington authorities. In order to pave the way for this part of the work, the recommendations have been developed with reference to the tax blank now in use, and with reference to *Statistics of Income* as now published (1929 edition).

The Committee has constantly in mind the necessity of setting up its recommendations with due regard for the dictates of governmental economy. Fortunately, it has been able to make many recommendations looking to the elimination of work now being done; and it is quite likely that the final set of detailed recommendations to which this report may lead will secure a net reduction in the size of *Statistics of Income* and in the work and cost of preparing it, except in certain years when supplementary surveys are made.

In reference to this last point, it should be noted that certain of the present and proposed tabulations are such that there is no need of having them every year. It is accordingly being recommended that many tabulations be made only at intervals of three to five years, and it is believed that this practice would bring a large saving in labor and cost, without greatly impairing the significance and usefulness of the data.

A technical device which would save an important amount of space in the publications and cost in their preparation is the adoption of larger units for stating the results in many tables; the use of hundreds or thousands

where dollars are now used in numerous cases, and the use of millions where thousands are now used, would secure important economies without reducing the usefulnes of the data. The aim to have the various tables "check" to the nearest dollar is of such slight importance in tabulations of this kind that the extra cost involved cannot possibly be justified.

With these general aims and considerations in view, the Committee has sought to make a series of recommendations which would result in obtaining a clear picture of changes in individual and corporate incomes in the United States, the distribution of such income by industrial and occupational groups, the changes in the financial position of the corporations of the country, and the impact of the income tax upon various economic groups without burdening unduly the taxpayer in making out his return or the Bureau of Internal Revenue in compiling and publishing the information based upon the returns. It is believed that the recommendations that are now being proposed will involve only slight changes in the tax blank, and might result—except once in three to five years—in an actual reduction in the size and cost of *Statistics of Income*. No close estimate on this last point can be made until the recommendations are worked out in greater detail.

The Joint Committee makes the following recommendations to each of the three associations represented:

1. That the Association approve in principle the specific recommendations listed below.

2. That the Association authorize the appointment of a delegation to a new Joint Committee, having power to: (a) fill in technical details of present recommendations; (b) establish and maintain contact, presumably through an agent, with federal officers, with a view to securing their cooperation in obtaining adoption of the proposed changes; (c) continue the investigations of the present Joint Committee, in order to work out further recommendations as needed.

3. That the Association authorize the Joint Committee to select such an agent as implied under 2(b) above, and provide a moderate appropriation for salary and traveling expenses of such an agent, or empower the Joint Committee to seek such an appropriation on the Association's behalf from other sources.

Respectfully submitted,

J. F. Ebersole
Ralph C. Epstein
Murray Haig

REPORT OF THE JOINT CENSUS ADVISORY COMMITTEE

The Advisory Committee on the Census held one meeting in 1932. At this meeting the following resolutions were adopted:

208. *Resolved,* That it is the sense of the Advisory Committee that the material giving a complete description of the Census of 1930, methods followed, scope, etc., shall not be printed as a publication of the Census Bureau but that copies shall be kept on file for the guidance of the Director at future enumerations.

209. *Resolved,* That it is the sense of the Advisory Committee that the decennial census of wealth, public debt, and taxation should be proceeded with by the Census Bureau.

210. *Resolved,* That it is the sense of the Advisory Committee that the Director of the Census should proceed with the regular decennial census of institutions covering the same classes as were included in the last decennial enumeration.

211. *Resolved,* That Dr. Paul E. Cherington serve as a committee of one to review the manuscript of one or two of these special bulletins on distribution, and make such recommendations regarding changes or additions as seem to him desirable.

212. *Resolved,* That the Committee approves the arrangements whereby the volumes under each main subject covered by the census are published as a separate series or set of volumes independently numbered so that there is one set of volumes on population, another on agriculture, etc., instead of numbering all the volumes consecutively as in previous censuses; that it also approves using the octavo size for those volumes for which the tabular matter can be conveniently presented in that format, even though most of the volumes will be of quarto size.

213. *Resolved,* That it is the sense of the Advisory Committee that it approves the proposed plans for the distribution of the final volumes as outlined by Dr. Hill.

214. *Resolved,* That it is the sense of the Advisory Committee that if possible the maps used for geographical divisions at the last census should be preserved and suitable filing cases secured for their safe storage.

215. *Resolved,* That it is the sense of the Advisory Committee that it strongly supports the Director in having family cards preserved and stored for the time being.

216. *Resolved,* That it is the sense of the Advisory Committee that there should be an Abstract compiled and printed for the Fifteenth Census as such.

217. *Resolved,* That it is the sense of the Advisory Committee that the motion in regard to the index be tabled and that Professor Chaddock and Professor King be appointed as a subcommittee on the census index and instructed to report to the committee at a later date.

Respectfully submitted,

E. E. DAY, *Chairman*

REPORT OF COMMITTEE ON RESEARCH

The Committee on Research that was authorized by the Executive Committee at the Washington meeting (*Proceedings*, March, 1932, p. 280) met in Washington on May 15, 1932, at the offices of the American Council of Learned Societies. There were present: Max S. Handman, chairman, and Professors George E. Barnett and F. S. Deibler. In addition there were present Dr. Meredith B. Givens, representing the Social Science Research Council, and Dr. Mortimer Graves, representing the American Council of Learned Societies.

The problem for consideration was the advisability of the appointment of a standing committee on research by the American Economic Association.

The practices of a number of other learned societies were examined as well as the report of the informal committee of the American Economic Association that was made at the last meeting of the Association (*Proceedings*, p. 295).

Your Committee discussed very fully the whole question of the encouragement and stimulation of research and while we fully realize that the scope of such a Committee is naturally limited because research is so much a matter of the individual scholar, yet we feel that there are occasions when such a standing committee can serve a very definite and useful purpose. This is particularly true in problems where the united efforts of the Association (co-operating with similar efforts of other associations) is needed in order to accomplish a scientific purpose in view. We therefore voted to make the following recommendations to the Executive Committee:

1. That the Executive Committee of the American Economic Association appoint a standing committee on research to consist of three members.

2. That the activities of the committee proceed along such lines as the following:

   a) To aid in co-operation with other scientific associations in the development of modes of collecting statistical and other information by governmental agencies. The Committee discussed in particular detail the problem of the collection of the fundamental statistical data so necessary to an adequate understanding of economic processes. It felt that the enormous activities connected with the collection of quantitative information by national, state, and municipal government should be re-evaluated by a group of competent scholars and some concerted effort be made to establish the basis for the collection of this material on the fundamental problems which are inherent in the discipline using statistical data, in so far as such re-evaluation does not run counter to the fundamental governmental purposes for which these collections are primarily made. If with a slight shift of emphasis, and perhaps a slight additional expense or no additional expense the material collected can be made to serve more adequate scientific as well as governmental purposes, the American Economic Association, along with similar scientific bodies, is entitled to put forth every effort in order to accomplish this aim. The Committee on Research

refers this problem to the Association, suggesting that a committee be set up to consider the national aspect, while to regional committees, discussed below, shall be entrusted the state and municipal aspects of this problem.

b) To aid in securing the co-operation of various governmental agencies in making available for scholars unpublished statistical data and other collections of information of scientific interest.

c) To foster and as far as possible to promote research in regional problems by regional bodies. This aspect of the problem was felt to be particularly important in the light of the uneven development both in research personnel and research facilities over the country. The Association can do a good deal in stimulating research interest in regional problems by giving these problems some share of attention on the annual program. Furthermore with some slight financial assistance small organizations could be set up in various states or national regions which shall act as regional clearing bodies for projects and suggestions bearing either on regional research problems or on regional research needs.

d) To endeavor to secure co-operation in monographic studies along comparable lines on such topics as state and municipal finance and other subjects of common interest. It was thought that some useful coordination might be also accomplished in this direction in connection with doctoral dissertations.

3. That the committee on research serve as a liaison body between the American Economic Association and other scientific organizations in considering research proposals. It may, on its own initiative, or upon the request of a member or members of the Association, or of another association, develop projects for investigation and research. All projects shall be presented to the Executive Committee for approval and for the appointment of an appropriate committee for the conduct of the work.

4. It is further recommended that the committee on research be authorized to co-operate with the American Research Library Association in developing plans for the preservation of significant regional materials of scientific interest and for making available at convenient centers throughout the country public documents of especial interest to social scientists.

Respectfully submitted,

MAX S. HANDMAN
GEORGE E. BARNETT
F. S. DEIBLER

PUBLICATIONS

OF THE

AMERICAN ECONOMIC ASSOCIATION

1932

FIRST SERIES

Numbers starred are sold only with the sets; the supply of those double starred is exhausted. For information apply to the Secretary.

Volume I, 1886

		Price in paper
1.	Report of Organization of the American Economic Association. Pp. 46.	$ .50
2-3.	** Relation of the Modern Municipality to the Gas Supply. By E. J. James. Pp. 66.	.75
4.	Co-operation in a Western City. By Albert Shaw. Pp. 106.	.75
5.	** Co-operation in New England. By E. W. Bemis. Pp. 136.	.75
6.	** Relation of the State to Industrial Action. By H. C. Adams. Pp. 85.	.75

Volume II, 1887

1.	Three Phases of Co-operation in the West. By Amos G. Warner. Pp. 119.	.75
2.	Historical Sketch of the Finances of Pennsylvania. By T. K. Worthington. Pp. 106.	.75
3.	The Railway Question. By Edmund J. James. Pp. 68.	.75
4.	Early History of the English Woolen Industry. By W. J. Ashley. Pp. 85.	.75
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6.	Relation of Modern Municipalities to Quasi-Public Works. By H. C. Adams and others. Pp. 87.	.75

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